

# **2017**

## **Oregon Department of Revenue**

### **Recommendations on Listed Jurisdictions**

**HB 2460 (2013 Regular Session)**

**Executive Summary**  
**January 1, 2017**





# Executive summary

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Section (4) of HB 2460 from the 2013 regular legislative session provides:

“On or before January 1 of each odd-numbered year, the Department of Revenue shall submit a report to the Legislative Assembly in the manner provided by ORS 192.245. The report shall include recommendations for legislation related to jurisdictions listed in ORS 317.715 (2)(b), including recommendations for additions to or subtractions from the list of jurisdictions in ORS 317.715(2)(b).”

This Executive Summary provides the Department of Revenue’s recommendations for additions to and subtractions from the jurisdictions listed in ORS 317.716(1)(b). The full report is available online at [www.oregon.gov/dor](http://www.oregon.gov/dor).

The purpose of the report is to explain the ORS 317.716(1)(b) recommendations. The report examines the history of the list and identifies the criteria that the department uses to determine recommendations. It also provides analysis of the foreign jurisdictions proposed for addition, retention, or subtraction using the established criteria.

The department used the listed jurisdiction criteria in ORS 317.717(1) through (5) to make its recommendations. ORS 317.717 is based on a Multistate Tax Commission (MTC) model statute that makes clear that only political jurisdictions can be listed jurisdictions. ORS 317.717 determines whether a jurisdiction is a listed jurisdiction by applying a two-step definition of listed jurisdiction.

The first step is determining whether the jurisdiction imposes “no or nominal tax on the relevant income.” The relevant income, for the purposes of this report, is corporate income.

The second step is determining whether the jurisdiction that imposes no or nominal tax on corporate income also meets at least one of the following five criteria:

- The jurisdiction does not disclose which corporate entities benefit from the jurisdiction’s tax system.
- The administrative and legal operation of the jurisdiction’s corporate tax system is not available to other parties.
- The jurisdiction allows the establishment of foreign-owned corporations with little or no economic presence in the jurisdiction.
- The benefits of the jurisdiction’s corporate tax system are unavailable to residents of the jurisdiction.
- The relevant facts indicate that the jurisdiction’s tax system favors tax avoidance.

For tax years beginning on or after January 1, 2017, the department recommends adding the following countries to the list of jurisdictions in ORS 317.716(1)(b) based on the accompanying MTC criteria:

- Ireland.
- Jordan.
- Lebanon.
- Macau.
- United Arab Emirates.

# **2017**

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# Recommendations for listed jurisdictions

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## Introduction

The Oregon Legislature enacted HB 2460 during the 2013 Legislative Session. The law requires the Department of Revenue to submit a report during odd-numbered years to the Legislative Assembly and include recommendations for legislation related to jurisdictions listed in ORS 317.716(1)(b). This includes recommendations for additions to or subtractions from the list of jurisdictions provided in ORS 317.716(1)(b).

ORS 317.716(1)(a) provides that corporations filing an Oregon corporate excise tax return shall compute their Oregon taxable income by including net income or loss from subsidiaries incorporated in the foreign jurisdictions listed in ORS 317.716(1)(b) to determine their starting point for computing Oregon taxable income.

Under Oregon law, a corporation's excise or income tax liability largely corresponds to federally reported taxable income. Therefore, when a corporate group shifts income offshore from the United States to a corporation in a foreign tax jurisdiction, that income will generally not be subject to tax in Oregon. A Congressional Research Service report in January 2015 estimated that federal corporate tax reductions resulting from shifting profits offshore range from about \$10 billion to \$90 billion annually.

For tax year 2014, Oregon taxpayers self-reported \$13.9 million in tax as a result of Oregon's listed jurisdiction law. The department will continue to collect data from taxpayer self-reporting and department compliance activities to evaluate the effect of the listed jurisdiction law.

## Definitions

**Captive insurance company:** Some corporate groups will form a separate subsidiary that is responsible for insuring the rest of the corporate group. The subsidiary that is responsible for insuring the rest of the corporate group is referred to as the captive insurance company. The other subsidiaries in the corporate group will pay insurance premiums to the captive insurance company.

**Earnings stripping:** At the most basic level, earnings stripping is the practice of using transactions between a corporate subsidiary in a high tax country and a corporate subsidiary in a low tax country to reduce the tax base in the high tax country and increase the tax base in the low tax country. Earnings stripping can be accomplished through hybrid financing instruments, licensing agreements, intra-corporate loans, and other methods.

**Effective tax rate:** Statutory tax rates are quoted in terms of marginal tax rates. For example, the U.S. corporate tax rate is 35 percent, which means that each additional dollar of taxable income is taxed at 35 percent. An effective tax rate, on the other hand, is the actual rate of tax paid by a company on all of its net income. Effective tax rates are usually lower than statutory tax rates because credits, deductions, and exemptions reduce taxable net income.

**Gross domestic product (GDP):** GDP is the monetary value of all goods and services pro-



duced within a particular jurisdiction.

**Group financing:** A corporate group will often set up a subsidiary that takes on the role of financing other subsidiaries within the corporate group. This usually involves the financing subsidiary loaning money to other subsidiaries in return for interest. Group financing is the term that describes this arrangement.

**Group licensing:** A corporate group will often set up a subsidiary that holds the intellectual property, such as copyrights or patents, for the entire corporate group. The subsidiary that holds the intellectual property will levy licensing fees on the other subsidiaries for the use of the intellectual property. Group licensing is the term that describes this arrangement.

**Holding company:** A holding company is a corporation that owns income-producing assets, but does not carry on any other business.

**Hybrid financing instrument:** Corporations raise money by issuing debt or issuing equity (stock). A hybrid financing instrument combines debt-like and equity-like characteristics into the same security. Hybrid financing instruments are sometimes created by conflicts between legal systems. For example, Country A may legally classify a financing instrument as debt, and Country B may legally classify the same financing instrument as equity. Accordingly, payments in Country A may be deductible, and payments received in Country B may be a non-taxable return of capital.

**IP box:** Some countries have adopted the practice of partially exempting income derived from intellectual property such as copyrights, patents or trademarks from taxation. For example, Andorra exempts 80 percent of the income derived from intellectual property from taxation. Accordingly, the IP box are the kinds of intellectual property activities that qualify for partial exemption from taxation.

**Notional interest deduction:** Typically, a corporate taxpayer is allowed to deduct interest paid on corporate indebtedness. It has been pointed out this creates an incentive for a corporate taxpayer to raise capital using debt rather than equity. A notional interest deduction attempts to remove the incentive favoring debt financing over equity financing by allowing a company to deduct a certain portion of their equity each year. Notional interest is sometimes referred to as “fictional interest” because the expense claimed does not represent a real financial cost.

**Resident company:** A corporation that is incorporated in or managed and controlled from a particular jurisdiction may be considered a resident of that jurisdiction. Rules for determining the residency of a corporation vary markedly between jurisdictions. Residency rules are typically used to determine what income of the corporation may be taxed by the jurisdiction of corporate residency.

**Tax avoidance:** Tax avoidance is the practice of minimizing tax bills through legal means. Tax evasion, on the other hand, refers to the practice of minimizing tax bills through illegal means.

**Territorial tax:** It has been noted that the purest system of territorial taxation is when a corporation’s active business income is taxed only in the jurisdiction that is the source of the income in question. Not all territorial tax systems work the same way because the rules for sourcing

income vary between jurisdictions. By way of contrast, U.S. corporations are taxed on their worldwide income although tax on foreign income is deferred until the income is repatriated to the U.S.

## History of listed jurisdictions

All of the listed foreign jurisdictions impose no or nominal taxation on relevant corporation income. In addition, all of the listed foreign jurisdictions share one or more of the following characteristics:

- Laws that prevent sharing of information with other governments.
- A lack of transparency, exclusion of resident taxpayers from the tax regime's benefits.
- Laws that allow foreign-owned entities to be established without a substantive presence in the jurisdiction.
- Laws that disallow resident taxpayers of the jurisdiction from taking advantage of tax benefits available to foreign-owned entities.
- The creation of a regime which is favorable to tax avoidance.

Oregon's list of foreign jurisdictions was originally modeled after Montana's foreign tax haven list under the Montana Code Annotated (MCA 15-31-322). Montana's foreign tax haven list was originally written in 2003 and revised in 2009. A 2012 Montana Department of Revenue legislative report indicates Montana's list of tax havens is primarily based on the list of tax havens and harmful preferential tax regimes produced by the Organization for Economic Cooperation and Development (OECD).

In 1998, the OECD published *Harmful Tax Competition: An Emerging Global Issue*, which defined tax havens and harmful preferential tax regimes. According to the report, both tax havens and potentially harmful tax regimes are jurisdictions that tax relevant income at a zero or nominal effective tax rate.

Additionally, tax havens engage in one or more of the following omissions:

- Lacking an effective exchange of information mechanism with tax authorities in other jurisdictions.
- Failing to provide a transparent operation of legislative, legal or administrative machinery of the jurisdiction.
- Failing to require that a person engage in some kind of substantial economic activity within the jurisdiction to take advantage of the favorable income tax regime.

Harmful preferential tax regimes engage in at least one of the following acts or omissions:

- Lacking an effective exchange of information mechanism with tax authorities in other jurisdictions.
- Failing to provide a transparent operation of legislative, legal, or administrative machinery of the jurisdiction.

- Insulating the tax preferred sector from the domestic market in the tax preferential jurisdiction.
- Allowing or otherwise establishing the presence of secondary criteria indicative of a tax haven. These may include:
  - A negotiable tax rate, exemption of foreign source income from tax in the jurisdiction.
  - The use of the jurisdiction to engage in activities conducted solely for tax reasons.

Between 2000 and 2006, the OECD issued progress reports on the countries it had identified as tax havens or harmful preferential tax regimes. The 2000 OECD progress report stated six tax haven countries had made “high level political commitment(s) to eliminate harmful tax practices” and were not explicitly included on the list of tax havens. Those countries were: Bermuda, Cayman Islands, Cyprus, Malta, Mauritius and San Marino. Also, the 2000 OECD progress report identified Luxembourg, among other countries, as hosting a harmful preferential tax regime.

Between 2001 and 2002, the OECD removed Barbados, Maldives and Tonga from its tax haven list. In its 2001 progress report, the OECD said it would no longer use the substantial activities test to identify tax havens because of the difficulty involved in determining whether an activity in a jurisdiction is substantial. In its 2006 progress report, the OECD indicated Luxembourg was the only remaining OECD country with a harmful preferential tax regime but was in the process of repealing it.

The OECD appears to have stopped tracking these countries by 2006. After 2006, the Global Forum, an organization of OECD and non-OECD states, began evaluating the exchange of information and transparency provisions of jurisdictions. The Global Forum began issuing annual reports on their evaluations.

As noted above, the 2003 Montana legislation included all tax havens explicitly listed in the 2000 OECD list of tax havens along with Bermuda, the Cayman Islands and Luxembourg. Montana amended its list of tax havens in 2009 by subtracting the Maldives and Tonga, and adding Cyprus, Malta, Mauritius and San Marino. Therefore, the 2009 Montana list of tax havens includes the 2000 OECD list of tax havens, the six jurisdictions identified by the OECD in 2000 as committed to eliminating harmful tax practices, and Barbados and Luxembourg.

In its 2012 report to the Montana Legislature, the Montana Department of Revenue indicated that it now relies less on OECD sources to recommend modifications to the Montana list of tax havens. They attribute this to a shift in OECD’s focus toward other topics and the availability of information from other sources. The Montana Department of Revenue is currently preparing a legislative recommendation for proposed additions to and subtractions from the list of foreign jurisdictions qualifying as tax havens.

## **Multistate Tax Commission tax haven criteria**

In 2006, the MTC defined the term “tax haven” in a model statute to include the jurisdictions that the OECD listed as tax havens, and OECD’s criteria for identifying preferential tax regimes.

On July 27, 2011, the MTC voted to delete all explicit references to the OECD for two reasons. First, the MTC noted that the OECD no longer kept lists of tax havens or preferential tax regimes. Second, the MTC noted that the OECD had “adopted new classifications and standards” to evaluate tax policies of jurisdictions. Therefore, the MTC deleted the first two paragraphs of its 2006 definition of tax haven.

The revised MTC model statute defines “tax haven” as a jurisdiction that, during the tax year in question, has no or nominal effective tax on the relevant income; and

- Has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;
- Has a tax regime which lacks transparency. A tax regime lacks transparency if the details of legislative, legal or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers, or if the information needed by tax authorities to determine a taxpayer’s correct tax liability, such as accounting records and underlying documentation, is not adequately available;
- Facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;
- Explicitly or implicitly excludes the jurisdiction’s resident taxpayers from taking advantage of the tax regime’s benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction’s domestic market; or
- Has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.

The 2011 MTC criteria are similar to the criteria used to produce the ORS 317.716(1)(b) list of foreign jurisdictions. The 2011 MTC criteria have been incorporated into the current version of ORS 317.716 and were used by the department when preparing this report.

## **Recommendations**

Detailed summaries on each jurisdiction below are available in Appendix 1. Based on the criteria described above, the department makes the following recommendations:

### ***Additions***

#### **Ireland**

Irish law allows for a corporation incorporated in Ireland to be exempt from Irish tax if the corporation in question is managed and controlled from a third country. Such a corporation managed and controlled from a third country can be referred to as a “stateless company,” which is when the company in question is not subject to taxation anywhere. Ireland’s stateless company law implicates ORS 317.717(3) because a corporation can avail itself of Ireland’s advantageous corporate tax system without a substantial connection to Ireland.

Please note, the Irish Finance Act from 2014 states that the Irish stateless company law will be

phased out by 2020.

The department recommends that Ireland be added to the list of jurisdictions in ORS 317.716(1)(b).

## Jordan

Jordanian law allows for the establishment of a Jordanian company that is tax exempt. However, this tax exempt Jordanian company cannot operate within the Jordanian economy. This implicates ORS 317.717(3) and (4).

The department recommends that Jordan be added to the list of jurisdictions in ORS 317.716(1)(b).

## Lebanon

Lebanese law allows for the establishment of a Lebanese company that is tax-exempt. However, this tax-exempt Lebanese company cannot operate within the Lebanese economy. This implicates ORS 317.717(3) and (4).

The department recommends that Lebanon be added to the list of jurisdictions in ORS 317.716(1)(b).

## Macau

Macau allows for the establishment of a Macau company that is tax exempt. However, the tax-exempt Macau company cannot operate within the economy of Macau. This implicates ORS 317.717(3) and (4).

The department recommends that Macau be added to the list of jurisdictions in ORS 317.716(1)(b).

## United Arab Emirates

The United Arab Emirates allows for the establishment of a company in the United Arab Emirates that has no substantial economic connection to the United Arab Emirates. Also, the United Arab Emirates does not impose income taxes on corporations, with certain limited exceptions for banks and oil and gas companies. This implicates ORS 317.717(3).

The department recommends that the United Arab Emirates be added to the list of jurisdictions in ORS 317.716(1)(b).

## **Subtractions**

At this time, the department does not recommend that any jurisdictions be removed from list in ORS 317.716(1)(b).

## **Previous years' recommendations and other countries considered for inclusion**

Previously, the Oregon Legislature chose not to add Hong Kong, the Netherlands, Panama, and Switzerland to the ORS 317.716 list of listed jurisdictions. The department investigated

Hong Kong, the Netherlands, Panama, and Switzerland for this report and found no new material facts related to these countries beyond those already considered by the Oregon Legislature.

The department also investigated the possibility of recommending the inclusion of Malaysia and Portugal to the ORS 317.716 list. However, the department is not recommending the inclusion of Malaysia or Portugal on the ORS 317.716 list because the department did not find sufficient facts to warrant their addition.

## **Conclusion**

Based on the ORS 317.717 listed jurisdiction determination criteria used by the department, the following countries should be added to the list of jurisdictions in ORS 317.716(1)(b):

- Ireland.
- Jordan.
- Lebanon.
- Macau.
- United Arab Emirates.

# Appendix 1

## ORS 317.716(1)(b) jurisdictions (current and proposed)

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ORS 317.717 criteria define a listed jurisdiction as a jurisdiction that has no or nominal tax on the relevant income, and:

- Has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;
- Has a tax regime which lacks transparency. A tax regime lacks transparency if the details of legislative, legal or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers, or if the information needed by tax authorities to determine a taxpayer’s correct tax liability, such as accounting records and underlying documentation, is not adequately available;
- Facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;
- Explicitly or implicitly excludes the jurisdiction’s resident taxpayers from taking advantage of the tax regime’s benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction’s domestic market; or
- Has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.

The table below lists the current jurisdictions listed in ORS 317.716 and the recommended additions and subtractions, which are bolded. All of these jurisdictions impose no or nominal taxation on certain categories of income earned outside of the jurisdiction. This table also shows which additional ORS 317.717 criteria cause the jurisdiction to be classified as a tax haven.

Jurisdictions	ORS 317.717 criteria met
Andorra	3
Anguilla	3, 4
Antigua and Barbuda	4
Aruba	3, 4
The Bahamas	3, 4, 5
Bahrain	3
Barbados	4, 5
Belize	3, 4

Bermuda	3, 5
Bonaire	3
British Virgin Islands	1, 2, 3, 5
Cayman Islands	3, 4, 5
Cook Islands	4
Curacao	4
Cyprus	2, 3
Dominica	1, 2, 4
Gibraltar	3
Grenada	3
Guatemala	1
Guernsey-Sark-Alderney	3
<b>Ireland</b>	<b>3</b>
Isle of Man	3
Jersey	3
<b>Jordan</b>	<b>3, 4</b>
<b>Lebanon</b>	<b>3, 4</b>
Liberia	2, 3
Liechtenstein	3
Luxembourg	1, 2, 3, 5
<b>Macau</b>	<b>3, 4</b>
Malta	3
Marshall Islands	2, 3, 4
Mauritius	3, 4
Montserrat	3, 4
Nauru	1, 2
Niue	2
Saba	3
St. Kitts and Nevis	4
St. Lucia	4
St. Vincent and the Grenadines	4
Samoa	4



San Marino	3
Seychelles	2, 3, 4
Sint Eustatius	3
Sint Maarten	4
Trinidad and Tobago	1
Turks and Caicos Islands	3, 4, 5
<b>United Arab Emirates</b>	<b>3</b>
U.S. Virgin Islands	4
Vanuatu	1, 2, 3

## **Andorra**

Andorra is a principality located in the Pyrenees Mountains with a population of approximately 85,000 people. Languages spoken in Andorra include: Catalan, Castilian, Portuguese and French. Andorra's economy is based on tourism, retail sales, and finance.<sup>1</sup>

Bureau of Economic Analysis (BEA) statistics indicate that U.S. corporations reported \$1 million worth of profits in Andorra during 2013.<sup>2</sup>

Until recently, Andorra did not tax corporate income.<sup>3</sup> As of 2016, Andorra imposes a 10 percent tax on corporate income.<sup>4</sup>

The corporate tax base for a firm in Andorra is reduced by 80 percent if the Andorran firm engages in group financing, intellectual property or international operations involving intangible assets or goods trading. To claim this exception, the Andorran firm must have business premises of 20 square meters and at least one part-time employee within Andorra.<sup>5</sup>

Andorra also possesses a holding company regime. Under this regime, an Andorran holding company can exclude foreign source dividends and capital gains from the taxable income of the Andorran holding company. However, the Andorran holding company must own at least 5 percent of the voting rights of the non-resident company distributing the dividends. Also, the dividend distributing company must be subject to paying taxes similar to Andorran tax rates.<sup>6</sup>

In summary, Andorra taxes group financing and intellectual property licensing activities at an effective rate of 2 percent and dividends at an effective rate of 0 percent if certain conditions are met. In any case, 2 percent is a nominal rate of tax given that rate is substantially lower than the effective tax rate on similar activities in other jurisdictions. No substantive presence in Andorra is required to take advantage of the Andorra tax regime, which implicates ORS 317.717(3).

## **Anguilla**

Anguilla is a Caribbean overseas territory of the U.K. with a population of approximately 16,000 people. English is the official language of Anguilla. The main industries are financial services, fishing, remittances, and tourism.<sup>7</sup>

BEA statistics indicate that U.S. corporations reported \$1 million in profits in Anguilla during 2013.<sup>8</sup> There are no corporate income taxes in Anguilla.<sup>9</sup>

Section 3 of the Anguilla International Business Companies Act provides that an Anguillan international business company may not carry on business with residents of Anguilla. Section 117 of the same act provides that an Anguillan international business company that only does business outside Anguilla is not subject to Anguillan tax.<sup>10</sup>

In summary, Anguillan international companies need not have a substantive presence in Anguilla to enjoy the Anguillan zero-tax regime. Also, Anguillan international companies are excluded from the Anguillan domestic market. This implicates ORS 317.717(3) and (4).

## **Antigua and Barbuda**

Antigua and Barbuda is a Caribbean island nation located near Puerto Rico with a population of approximately 92,000 people. English is the official language of Antigua and Barbuda. The main industry is tourism.<sup>11</sup>

BEA statistics indicate that U.S. corporations reported \$2 million in losses in Antigua and Barbuda during 2013.<sup>12</sup>

Antigua and Barbuda has a corporate income tax rate of 25 percent.<sup>13</sup> Section 4 of the Antigua International Business Companies Act defines the term international trade or business companies and limits the activities of those companies within Antigua and Barbuda. Manufacturing companies registered under the act may manufacture goods for sale outside of Antigua and Barbuda. However, the act also allows international trading companies registered under the act to provide services to other corporations within Antigua and Barbuda, as long as those services are not performed to enable another company to conduct business within Antigua and Barbuda.<sup>14</sup>

Section 272 of the act provides that the international trade and business income of an Antigua international business corporation is exempt from tax in Antigua. Section 276 provides that this tax exemption lasts for 50 years after the incorporation of the exempt company.<sup>15</sup>

In summary, Antigua international business corporations are exempt from tax if they limit their interactions with the Antiguan economy. This implicates ORS 317.717(4).

### **Aruba**

Aruba is a Caribbean island constituent country of the Netherlands with a population of approximately 112,000 people. Papiamentu is the most prevalent language of Aruba. The main industries include tourism, business, and financial services.<sup>16</sup>

BEA statistics indicate that U.S. corporations reported \$2 million in profits in Aruba during 2013.<sup>17</sup> Aruba taxes corporate income at a rate of 25 percent.<sup>18</sup>

Aruban law provides for the establishment of an Aruba exempt company (AVV). Residents of Aruba may not incorporate an AVV. An AVV may not participate in the domestic economy of Aruba.<sup>19</sup> However, an AVV may engage in activities such as intellectual property licensing and corporate group financing.<sup>20</sup> An AVV, as long as it does not engage in the domestic economy of Aruba, is exempt from Aruban tax.<sup>21</sup>

In summary, Aruban law provides that AVVs that do not participate in the Aruban economy are tax-exempt. Also, Aruba does not allow Aruban residents to establish AVVs. In addition, there is no requirement that the AVV have a substantial connection to Aruba in order to take advantage of the Aruban tax system. This implicates ORS 317.717(3) and (4).

### **The Bahamas**

The Bahamas is a chain of islands located in the Caribbean Sea adjacent to Florida with a population of 324,000 people. English is the official language. Tourism and offshore banking are the main economic activities in the Bahamas.<sup>22</sup>

U.S. corporations reported \$2.234 billion in profits in the Bahamas during 2013.<sup>23</sup> The Bahamas has a corporate income tax rate of 0 percent.<sup>24</sup>

Section 187 of the Bahamian International Business Companies Act makes clear that a Bahamian company incorporated under the act is not subject to any kind of tax on company net income. Section 187(2) of the same act prevents an international business company partially owned by persons resident in the Bahamas from taking advantage of the provisions of Section 187(1). Nowhere does the act require a substantial presence in the Bahamas to take advantage of the zero-tax rate.<sup>25</sup>

In addition, it has been noted that finance and offshore banking generates as much as 35 percent of the GDP in the Bahamas.<sup>26</sup> Therefore, the untaxed offshore finance industry is large relative to the Bahamian economy. Accordingly, the Bahamas has created a tax regime favorable for tax avoidance.

In summary, the Bahamas allows international business companies to enjoy the Bahama's zero-tax rate without a substantial presence in the Bahamas. Also, residents of the Bahamas may not own part of an international business company. This implicates ORS 317.717(3) and (4). Additionally, the untaxed offshore finance industry is a large part of the Bahamian economy, implicating ORS 317.717(5).

## **Bahrain**

Bahrain is an island nation located between Saudi Arabia and Qatar in the Persian Gulf, with a population of approximately 1.3 million people. Arabic is the official language of Bahrain. The main industries are aluminum, construction, finance, and petroleum.<sup>27</sup>

BEA statistics indicate that U.S. corporations reported \$120 million in profits in Bahrain during 2013.<sup>28</sup> Bahrain does not have a corporate income tax for most companies. However, oil companies are taxed at a 46 percent rate.<sup>29</sup>

Bahraini law does allow for the establishment of holding companies that provide group financing to affiliated corporations. The Bahraini holding company may be completely owned by non-Bahraini nationals. There is no requirement that the holding company transact business with Bahraini companies. There is no requirement that corporations doing business with the holding company be subject to tax in other countries.<sup>30</sup>

In summary, a foreign company can be incorporated in Bahrain and take advantage of a 0 percent tax rate without the need for a local substantive presence within Bahrain. This implicates ORS 317.717(3).

## **Barbados**

Barbados is a Caribbean Island near South America with a population of approximately 290,000 people. English is the official language of Barbados. Tourism and offshore finance are the main economic activities.<sup>31</sup>

In 2013, U.S. corporations reported \$2.053 billion in profits in Barbados.<sup>32</sup> Barbados has a variety of corporate tax rates and international company structures, and taxes standard companies at a rate of 25 percent. Tax rates vary between .25 percent and 2.5 percent for Barbados international business companies.<sup>33</sup>

Section 10 of the International Business Companies Act provides that profits are taxed at a rate of 2.5 percent for the first \$10 million of profits, 2 percent for the second \$10 million of profits, 1.5 percent for the third \$10 million of profits, and 1 percent for all profits in excess of \$30 million.<sup>34</sup>

Section 8 of the same act requires that the international business company must be resident in Barbados and capable of carrying on business. Section 6(1)(d) provides that any business carried on from Barbados can qualify for the tax exemptions of the International Business Companies Act. However, Section 4 makes clear that items manufactured within Barbados must be exported. Section 6 makes clear that services must be provided to those outside Barbados or other similarly exempt companies within Barbados.<sup>35</sup>

In addition, it has been noted that offshore finance is an important foreign exchange earner in Barbados. The profits reported by U.S. corporations in Barbados equal approximately 40 percent of Barbados' GDP.<sup>36</sup> This indicates that the Barbados untaxed offshore financial sector is a significant part of the economy. Accordingly, Barbados has created a tax regime favorable for tax avoidance.

In summary, Barbados taxes international business company income at a nominal rate of between 1 percent and 2.5 percent if the international business company doesn't participate in the Barbados economy. This implicates ORS 317.717. Additionally, the Barbados untaxed offshore financial industry is a significant part of the country's economy, implicating ORS 317.717(5).

### **Belize**

Belize is a country located between Guatemala and Mexico with a population of approximately 347,000 people. English is the official language of Belize. The main industries include agriculture, petroleum, and tourism.<sup>37</sup>

BEA statistics indicated that U.S. corporations reported \$3 million in profits in Belize during 2013.<sup>38</sup> Belize taxes corporate income at a 25 percent rate.<sup>39</sup>

Belize has enacted an International Business Companies Act. Section 5 (1)(a) of the act provides that a Belizean international business company may not carry on activities within Belize. Section 130 of the same act provides that a Belizean international business company is exempt from Belizean corporate income tax.<sup>40</sup>

In summary, there is no tax on an international business company and the international business company may not enter the domestic market of Belize and, accordingly, does not need a substantial connection to Belize. This implicates ORS 317.717(3) and (4).

### **Bermuda**

Bermuda is an overseas territory of the U.K. consisting of a group of islands off the coast of South Carolina with a population of approximately 70,000 people. English is the official language of Bermuda. The main industries are finance and tourism.<sup>41</sup>

U.S. corporations reported a total of \$76.474 billion in profits from Bermuda during 2013.<sup>42</sup> News reports indicate that Google used Bermuda as part of a tax avoidance strategy involving Ireland and the Netherlands.<sup>43</sup> Bermuda does not levy a corporate income tax.<sup>44</sup>

Section 127 of the 1981 Bermuda Companies Act provides for the existence of Bermudian exempted companies. Section 129(e) provides that an exempted company, as a general rule, may not carry on business within Bermuda unless the activities of the exempted company fit within a specific exemption. Section 128 states that exempt companies are covered by the Exempted Undertakings Tax Protection Act of 1966.<sup>45</sup> Section 2 of that act authorizes the Bermuda Accountant-General to assure exempt companies that they will not be subject to any future Bermuda profits tax.<sup>46</sup>

In addition, the profits reported by U.S. corporations in Bermuda are many times larger than the GDP of Bermuda. It is clear that Bermuda's untaxed, offshore finance industry is large relative to the rest of the economy in Bermuda.<sup>47</sup> Therefore, it is also clear that Bermuda has created a tax regime favorable for tax avoidance.

In summary, a tax-exempt company may be established in Bermuda without the need for a substantive presence in Bermuda. This implicates ORS 317.717(3). Also, Bermuda has a large untaxed offshore financial services industry, implicating ORS 317.717(5).

### **Bonaire**

Bonaire is a Caribbean Island under the direct administration of the Netherlands with a population of approximately 19,000. The main language in Bonaire is Dutch.<sup>48</sup> The main industry is tourism.<sup>49</sup>

U.S. corporations reported \$7 million in profits in the Netherlands Islands in the Caribbean during 2013.<sup>50</sup>

Corporations in Bonaire are subject to a 5-percent distribution tax imposed on proceeds from shares. A corporation that performs group financing or licensing activities must have at least three employees and an office in Bonaire, Saba, or Sint Eustatius.<sup>51</sup>

In summary, Bonaire allows the establishment of companies without the need for a substantial tie to Bonaire. This implicates ORS 317.717(3).

### **British Virgin Islands**

The British Virgin Islands (BVI) is a U.K. overseas territory located in the Caribbean Sea near Puerto Rico with a population of approximately 33,000 people. The official language of the BVI is English. The BVI's most important industries are international business and tourism.<sup>52</sup>

BEA statistics show that U.S. corporations reported \$57.108 billion in profits in the "United Kingdom Islands, Caribbean" during 2013.<sup>53</sup> World Bank statistics show that the BVI received \$51 billion in foreign investments during 2015. The United States, by comparison, reported \$409 billion in foreign investments during 2015.<sup>54</sup>

In 1984, the BVI passed the International Business Companies Act. In essence, the international business company would not be taxed by the BVI if it did no business in the BVI. In 2004, the BVI replaced the International Business Companies Act and BVI international business companies were eventually phased out. However, the BVI has a corporate income tax rate of zero.<sup>55</sup>

BVI company law indicates there is no requirement that a company have a substantial presence in the BVI to take advantage of the corporate income tax rate.<sup>56</sup> This is supported by the fact that the foreign investment received by the BVI is disproportionate to the level of economic activity supportable by 33,000 people.

A Global Forum report indicates that the BVI is largely compliant with global standards related to tax transparency and exchange of information for tax purposes. The Global Forum upgraded the BVI's rating to largely compliant in March 2015.<sup>57</sup> Prior to that time, the Global Forum found that the BVI failed to enforce its exchange of information and tax transparency laws.<sup>58</sup>

The circumstances described here indicate that the BVI has established a tax regime favorable for tax avoidance. The BVI has a large untaxed offshore financial sector due to the large flow of foreign funds and the BVI has no corporate income tax. Additionally, total foreign investment into the BVI is greater than the GDP of the BVI.<sup>59</sup> Accordingly, the untaxed offshore financial sector must be a large part of the BVI economy.

In summary, there is no requirement that a foreign-owned entity establish a substantive presence in the BVI to take advantage of the zero corporate income tax rate. This implicates ORS 317.717(3). The BVI also has a large untaxed offshore financial services industry, implicating ORS 317.717(5).

### **Cayman Islands**

The Cayman Islands is a U.K. overseas territory located in the Caribbean near Cuba with a population of approximately 56,000 people. English is the official language of the Cayman Islands. Financial services and tourism are the main industries.<sup>60</sup>

There is no information indicating how much profit U.S. corporations earn specifically in the Cayman Islands. However, other statistics indicate that U.S. corporations reported \$57.108 billion in profits during

2013 in Caribbean islands belonging to the U.K.<sup>61</sup> The Cayman Islands does not have a corporate income tax.<sup>62</sup>

The Cayman Islands allows a Cayman Islands company that does business primarily outside the Cayman Islands to enjoy its corporate tax advantages. Section 165 of the Cayman Islands Companies Law provides that an exempt company must declare that their business will be carried on mainly outside the Cayman Islands. Section 174 of the law clearly prohibits trade by the exempt company within the Cayman Islands unless the trade within the Cayman Islands somehow furthers its trade outside the Cayman Islands.<sup>63</sup>

Also, the Cayman Islands have created a tax regime favorable for tax avoidance. Statistics indicate that the Cayman Island received approximately \$19 billion in net foreign investment during 2013.<sup>64</sup> It has been noted that the Cayman Islands is a thriving offshore financial center.<sup>65</sup> Clearly, the offshore financial center in the Cayman Islands is untaxed and constitutes a large part of the Cayman Islands economy.

In summary, the Cayman Islands does not tax corporate income and facilitates the establishment of foreign-owned corporations in the Cayman Islands without the need for an economic presence there. Also, exempt companies in the Cayman Islands may not participate in the Cayman Islands domestic market. This implicates ORS 317.717(3) and (4). Additionally, the Cayman Islands possess a large, untaxed offshore financial services industry, implicating ORS 317.717(5).

### **Cook Islands**

The Cook Islands are a group of South Pacific Islands with a population of approximately 10,000 inhabitants who are in a self-governing association with New Zealand. English and Cook Islands Maori are the official languages of the Cook Islands. The main industries are agriculture and tourism.<sup>66</sup>

No statistics are available on how much profit U.S. corporations report in the Cook Islands.<sup>67</sup> The Cook Islands levy a company tax of 20 percent on resident companies and 28 percent on non-resident companies.<sup>68</sup>

Section 249(2) of the Cook Islands International Companies Act provides that no “fee, impost, tax, levy, dues, duty or excise” may be imposed on a Cook Islands international company incorporated in the Cook Islands. Section 6 of the same act expressly forbids residents or domestic corporations of the Cook Islands from holding an interest in a Cook Islands international company except through a trustee company.<sup>69</sup>

The Cook Islands International Companies Act has been amended a number of times. However, a provision of the act that prevents domestic companies or residents of the Cook Islands from owning a beneficial interest in a Cook Islands international company has never been modified.<sup>70</sup>

In summary, residents of the Cook Islands are expressly excluded from the favorable tax treatment granted to Cook Island international companies established by non-Cook Islanders. This implicates ORS 317.717(4).

### **Curacao**

Curacao is an independent nation located in the Caribbean with a population of approximately 148,000 people. Dutch, English and Papiamentu are spoken in Curacao.<sup>71</sup>

BEA statistics for 2013 related to the amount of profits reported by U.S. corporations in Curacao were suppressed to avoid disclosing the identity of individual companies.<sup>72</sup> Curacao taxes corporate income at a rate of 22 percent.<sup>73</sup> However, Curacao allows for the establishment of an exempt company. However, this exempted company must limit its activities to financial investments and the licensing of intellectual property.<sup>74</sup>

In summary, Curacao allows the establishment of tax exempt companies that may not participate in the domestic market of Curacao. This implicates ORS 317.717(4).

## **Cyprus**

Cyprus is an island nation located in the eastern Mediterranean with a population of approximately 1.2 million people. Greek and Turkish are the official languages of Cyprus. Cyprus has a diversified economy, and finance and tourism are important industries.<sup>75</sup>

BEA statistics indicated that U.S. corporations reported \$363 million in profits in Cyprus during 2013.<sup>76</sup>

Cyprus experienced a severe financial crisis in 2013. A large part of deposits in Cypriot banks were, in essence, seized by the European Union to fund a bank bailout in Cyprus.<sup>77</sup> News articles reported that Cyprus remained a favorite tax haven in spite of the bank bailout.<sup>78</sup> Cyprus taxes resident corporate income at 12.5 percent.<sup>79</sup>

Cypriot companies are resident in Cyprus when the Cypriot company is managed and controlled from Cyprus. Resident Cypriot companies are taxed on their worldwide income. Non-resident Cypriot companies are taxed on Cypriot-source income.<sup>80</sup> Accordingly, a company can be incorporated in Cyprus and pay zero tax if the company has no Cyprus source income.

Dividends received by a resident Cypriot corporation are tax-free unless the dividends are paid out of profits more than four years old. In that case, the dividends are taxed to provide for the defense of Cyprus. Dividends received by non-resident Cypriot corporations are also exempt from tax, including the tax for the defense of Cyprus, unless more than half of the non-resident corporation's income comes from investment activities or the tax on the non-resident payer of the dividends is less than 5 percent of the tax on the receiving Cypriot corporation.<sup>81</sup>

Cyprus exempts 80 percent of the profits earned from patents, trademarks, and other intellectual property rights from tax. A company taking advantage of this tax incentive must own the intellectual property in question although the company may acquire the intellectual property from a third party. However, this exemption will sunset by 2021.<sup>82</sup>

The Global Forum now states that Cyprus is "largely compliant" with international standards related to tax transparency and exchange of tax information.<sup>83</sup> Before, a Global Forum report indicated that Cyprus failed to enforce its exchange of information and tax transparency laws.<sup>84</sup>

In summary, a strong potential exists for a Cypriot company to pay an effective rate of corporate tax significantly lower than the U.S. rate if the company holds intellectual property. Also, the potential for use of hybrid financing arrangements exists given the exclusion of dividends from Cyprus tax. These tax incentives can be used by a non-resident company without a substantial connection to Cyprus. This implicates ORS 317.717(3). Also, Cyprus' tax transparency practices are insufficient, implicating ORS 317.717(2).

## **Dominica**

Dominica is an island republic located in the Caribbean with a population of approximately 73,000 people. English is Dominica's official language. Agriculture is Dominica's main industry, along with developing finance and tourism sectors.<sup>85</sup>

The amount of profit or loss reported by U.S. corporations in Dominica for 2013 has been suppressed to avoid disclosing the identity of individual taxpayers.<sup>86</sup> Dominica taxes corporate income at 25 percent.<sup>87</sup>



Dominica passed an International Business Companies Act in 1996. Section 5(1)(a) of the act provides that an international business company may not carry on business in Dominica with persons domiciled in or residents of Dominica. In addition, Section 109 of the act provides that an international business company is exempt from tax for a period of 20 years after its incorporation.<sup>88</sup>

A Global Forum report indicated that Dominica lacked the following exchange of information and tax transparency provisions:

- Sufficient corporate accounting regulations.
- Sufficient ability of the government to obtain taxpayer information.
- Effective exchange of information provisions.<sup>89</sup>

However, Dominica has addressed these issues and the Global Forum has moved Dominica to a Phase 2 review. This means that Dominica's laws related to exchange of information and tax transparency have been reformed and are now sufficient and ready to be evaluated by Dominica's international peers. This evaluation is to determine how well Dominica's exchange of information and tax transparency laws function in practice.<sup>90</sup>

In summary, there is no tax for international businesses for the first 20 years of their operation, and these businesses cannot compete in the domestic Dominican market, implicating ORS 317.717(4).

### **Gibraltar**

Gibraltar is a small peninsula on the Spanish coast and has been a U.K. overseas territory for the past 300 years. Gibraltar's population is approximately 29,000 people. English is the official language of Gibraltar. The main economic activities are financial services, internet gaming, shipping, and tourism.<sup>91</sup>

U.S. corporations reported \$1.876 billion in profits in Gibraltar in 2013.<sup>92</sup> At present, the corporate income tax rate in Gibraltar is 10 percent.<sup>93</sup>

Gibraltar distinguishes between resident and non-resident companies. A Gibraltar resident company is one that is managed and controlled in Gibraltar. A Gibraltar non-resident company is managed and controlled outside Gibraltar. Typically, Gibraltar non-resident companies are taxed only on their Gibraltar-source income. However, a company registered in Gibraltar must pay the standard 10-percent corporate tax rate on interest and royalty income received.<sup>94</sup>

Also, Gibraltar exempts dividends from tax and there is no evidence that dividends paid to a Gibraltar recipient from another country be subject to tax in that country.<sup>95</sup>

Gibraltar's treatment of dividends could give a taxpayer a tax benefit, if the U.S. considered debt what Gibraltar considers to be equity. In short, a U.S. corporation could deduct the payment and a Gibraltar corporation would recognize no income on the payment.

In summary, Gibraltar excludes a large amount of foreign income from its taxable base by unconditionally excluding dividends from corporate taxable income. A Gibraltar company can take advantage of this tax regime without any substantive connection to Gibraltar. This implicates ORS 317.717(3).

### **Grenada**

Grenada is an island nation located in the Caribbean Sea near the coast of South America with a population of approximately 110,000 people. English is the official language of Grenada and tourism is a major industry.<sup>96</sup>

BEA statistics show that U.S. corporations reported \$3 million in profits in Grenada during 2013.<sup>97</sup> Grenada has a corporate income tax rate of 30 percent.<sup>98</sup>

Grenada allows the establishment of international companies that are exempt from tax for a period of 20 years, per Section 110 of the International Companies Act of 1989. Section 5 of the same act provides that an international company may not carry on business with persons domiciled or resident in Grenada.<sup>99</sup>

In summary, tax-exempt companies in Grenada are prevented from competing in the local Grenada market. Also, an exempt company does not need to have a substantial connection to Grenada. This implicates ORS 317.717(3).

## **Guatemala**

Guatemala is a Central American nation with a population of approximately 15,000,000 people. Spanish is the official language of Guatemala. Agriculture and remittances from abroad are major parts of the Guatemalan economy.<sup>100</sup>

BEA statistics indicate that U.S. corporations reported \$197 million in profits in Guatemala during 2013.<sup>101</sup> Guatemala has corporate income tax rates of 5 to 7 percent on gross revenue and 25 percent on net income.<sup>102</sup>

However, Guatemala only taxes Guatemalan-source income.<sup>103</sup> For example, dividends paid by foreign corporations to Guatemalan corporations are not taxable by Guatemala.<sup>104</sup> Also, Guatemalan law provides for a 10-year exemption from income taxes for companies that establish commercial or industrial operations in certain areas.<sup>105</sup>

However, the Guatemalan Congress has limited this tax exemption law, but a service user in a “free zone” will be able to complete its tax-exempt term. A free zone is an area within Guatemala that provides special incentives for businesses.<sup>106</sup> Therefore, it is still possible for a corporation established in Guatemala to enjoy zero taxation, at least for the first 10 years of its existence.

Also, Guatemala is not compliant with Global Forum exchange of information and transparency provisions. Notably, the Global Forum has noted deficiencies in the following areas:

- Availability of ownership information.
- The power of authorities to procure documents for exchange of information.
- Provisions for effective exchange of information.
- Exchange of information agreements that cover all relevant partners.<sup>107</sup>

Specifically, the report notes that Guatemala does not require foreign corporations, partnerships, or trusts with nexus to Guatemala to provide ownership information to Guatemala. Guatemala’s confidentiality provisions may not be waived for the purpose of exchange of information with other governments.<sup>108</sup>

Also, Guatemalan law may not authorize Guatemalan taxing authorities to obtain information unless the information relates to a Guatemalan tax liability. Guatemala’s confidentiality laws would render ineffective any exchange of information agreement Guatemala is party to, although. Guatemala has not actually entered into any of these agreements.<sup>109</sup> In addition, Global Forum has noted that Guatemala should modify their law to prevent notification of taxpayers when a judicial order is required to obtain taxpayer information.<sup>110</sup> There is no evidence the Global Forum has changed their negative evaluation of Guatemala’s effective exchange of tax information laws.<sup>111</sup>

In summary, Guatemala has a tax rate of zero on foreign source income and lacks effective exchange of information provisions. This implicates ORS 317.717(1).

### **Guernsey- Sark- Alderney**

Guernsey-Sark-Alderney (Guernsey) is a crown dependency of the U.K. located in the English Channel with a population of approximately 66,000 people. English is the predominant language. Financial activities are a very important part of the Guernsey economy.<sup>112</sup>

There are no statistics indicating the profits U.S. corporate entities report in Guernsey. In general, Guernsey's corporate tax rate is zero.<sup>113</sup> However, banking, fiduciary, domestic insurance, insurance management, and insurance intermediary businesses are taxed at a rate of 10 percent. Guernsey real estate holdings are taxed at 20 percent.<sup>114</sup>

A company is regarded as resident of Guernsey if the company is incorporated in Guernsey or is managed and controlled from Guernsey.<sup>115</sup> For a resident company to do business in Guernsey, the company need only file a simple tax return if they have no beneficial owners present in Guernsey and refrain from engaging in activity taxed by Guernsey.<sup>116</sup>

In summary, a foreign owned business may enjoy a tax rate of zero, without the need to engage in substantive activity within Guernsey. This implicates ORS 317.717(3).

### **Ireland**

Ireland is an island republic located in the North Atlantic Ocean off the western coast of England with a population of approximately 4,800,000. English is the official language of Ireland, although Irish is widely spoken. Ireland has a diversified economy that is orientated toward international trade. Much investment and business activity has been attracted to Ireland due to Ireland's tax provisions and well-educated workforce. Also, Ireland is a European Union member.<sup>117</sup>

U.S. corporations reported approximately \$105 billion in profits in Ireland during 2013.<sup>118</sup> Ireland taxes corporate trading income at 12.5 percent and non-trading corporate income at 25 percent.<sup>119</sup>

Irish law has traditionally provided that a company incorporated in Ireland could elect to be "stateless." In essence, judge-made law in Ireland provided that the tax residence of a company is where company is managed and controlled from.<sup>120</sup>

Therefore, an Irish company could be managed and controlled from a jurisdiction that determines tax residence based on incorporation. This means the Irish company is not tax-resident in Ireland or in the other jurisdiction. In essence, Ireland allows Irish incorporated companies to exclude a large portion of their profits from taxation by operating a stateless subsidiary and shifting profits to that stateless subsidiary.

Ireland codified this common law understanding in Section 23A of the Taxes Consolidation Act of 1997. Ultimately, that act provided that Irish companies would pay no tax, so long as a subsidiary of the company carried out a trade or business within Ireland.<sup>121</sup>

Section 39 of the Irish Finance (No. 2) Act of 2013 provides that an Irish incorporated company that is stateless is resident in Ireland from January 1, 2015. However, the application of the law is limited to those companies managed or controlled from a "relevant territory." There is nothing in the act that defines the term "relevant territory." However, an Irish government publication notes that the definition of "relevant territory" in Section 23A of the Taxes Consolidation Act of 1997 means an EU member-state or a country Ireland has a tax treaty with.<sup>122</sup>

A cursory glance at an Irish government website indicates that Ireland does not have tax treaties with Aruba or the Bahamas, among other low tax jurisdictions listed in ORS 317.716(1)(b).<sup>123</sup> This means that a corporation incorporated in Ireland and managed and controlled from a listed jurisdiction pays no tax to Ireland. Currently, the net income of such an Irish corporation is not added back to Oregon taxable income because the Irish corporation is not incorporated in the listed jurisdiction in spite of taking advantage of the listed jurisdiction's favorable tax structure.

In addition, Section 43 of the Irish Finance Act of 2014 provides that companies incorporated in Ireland prior to January 1, 2015 will be deemed to be a tax-resident in Ireland only until January 1, 2021.<sup>124</sup> This supports the conclusion that a "relevant territory" is limited to EU members or countries that Ireland has a tax treaty with. It follows that Ireland will not impose tax on Irish firms incorporated in many low-tax jurisdictions, such as Aruba or the Bahamas, until 2021.

The department did investigate Ireland for inclusion in the 2015 listed jurisdiction report. At that time, it was unclear to the department what the term "relevant territory" meant. Specifically, it was not clear whether "relevant territories" included low-tax jurisdictions. This uncertainty was resolved by the information provided in the Irish Finance Act of 2014. It should be noted that the Irish Finance Act of 2014 did not become law until December 23, 2014.<sup>125</sup> By then, the department simply did not have the time to revise its 2015 listed jurisdiction report because that report had a due date of January 1, 2015.

As noted above, Ireland is an EU member. The EU has a law similar to Oregon's listed jurisdiction law although the EU's list does not include Ireland.<sup>126</sup> The EU has pursued a number of initiatives to pursue tax transparency, exchange of tax information, and fair tax competition.<sup>127</sup> Recently, the EU directed its member states (including Ireland) to enact legislative changes by January 1, 2018 that promote tax transparency, exchange of tax information, and fair tax competition. Some of these legislative changes include provisions related to the following areas: hybrid mismatches, interest restrictions, and foreign-controlled corporations.

<sup>128</sup>

Ireland is in the process of complying with the EU's directive. Ireland has introduced legislation in the Irish Finance Bill of 2016 to require country-by-country reporting by multinational corporations.<sup>129</sup> However, there is no indication that Section 43 of the Irish Finance Act of 2014 is affected by the provisions in the Irish Finance Bill of 2016.<sup>130</sup>

There are many U.S. corporations conducting productive economic activities in Ireland. Statistics from 2013 indicate that U.S. corporations in Ireland reported \$108.826 billion in before-tax profits but paid \$3.581 billion in foreign income taxes.<sup>131</sup> This indicates that U.S. corporations in Ireland paid an effective tax rate of 3.29 percent. Therefore, the fact that U.S. corporations in Ireland conduct substantive economic activity needs to be weighed against the fact that U.S. corporations in Ireland pay an effective tax rate below 3.5 percent, as a whole.

In summary, Ireland will offer a nominal tax rate to Irish incorporated companies that are managed or controlled from a third country until at least January 1, 2021. This squarely implies that a corporation can benefit from the Irish tax structure without a substantive connection to Ireland. This implicates ORS 317.717(3). Accordingly, the department recommends that Ireland be included in the list of jurisdictions in ORS 317.716(1)(b).

## **Isle of Man**

The Isle of Man is a crown dependency of the U.K. located between Ireland and the U.K., with a population of approximately 87,000 people. Languages used in the Isle of Man include English and Manx. Manufacturing, offshore banking, and tourism are the basis of the Isle of Man economy.<sup>132</sup>

There are no statistics indicating the level of profits U.S. corporate entities report in the Isle of Man.<sup>133</sup> The Isle of Man taxes most businesses at a 0 percent tax rate. However, banking income from deposit-taking businesses, real estate, and retail profits in excess of 500,000 pounds are taxed at 10 percent. Also, income from land and property in the Isle of Man is taxed at 20 percent.<sup>134</sup>

The only requirement to take advantage of the 0 percent tax rate is to own an Isle of Man incorporated business entity or manage the business entity from the Isle of Man. All companies incorporated in the Isle of Man are tax residents in the Isle of Man.<sup>135</sup>

There is no requirement for an Isle of Man company to have a substantial presence in the Isle of Man to take advantage of the 0-percent tax rate.

In summary, Manx incorporated businesses are subject to a tax rate of zero, without the need for a substantive presence in the Isle of Man. This implicates ORS 317.717(3).

## **Jersey**

Jersey is a crown dependency of the U.K. located in the English Channel with a population of approximately 97,000 people. English is the official language of Jersey. Finance is a major component of the Jersey economy.<sup>136</sup>

There are no statistics indicating the level of profits U.S. corporate entities report in Jersey.<sup>137</sup> Jersey taxes most businesses at a 0-percent tax rate. However, Jersey taxes financial services companies at a 10-percent rate and utility companies at a 20-percent rate.<sup>138</sup>

A company is considered tax resident in Jersey if the company is incorporated in or managed and controlled from Jersey. There is no requirement that a company have any economic activities in Jersey to take advantage of the 0-percent tax rate.<sup>139</sup>

In summary, Jersey does not require a substantial connection to Jersey to set up a foreign-owned company there. A Jersey permanent establishment is only needed if corporation in question is not resident in Jersey. This implicates ORS 317.717(3)

## **Jordan**

Jordan is located in the Middle East and is home to approximately 8 million people. It has been noted that Jordan has a limited exposure to overseas capital markets.<sup>140</sup>

BEA statistics indicated that U.S. corporations reported \$61 million in profits in Jordan during 2013.<sup>141</sup> In general, Jordan taxes corporate income at a 20-percent rate. However, Jordan makes a number of tax incentives available to Jordanian companies. For example, a 14-percent rate applies to the Jordanian industrial section.<sup>142</sup>

One accounting industry publication indicates that Jordan exempts “foreign non-operating companies” from tax if the company makes its money outside Jordan.<sup>143</sup> The Amman Chamber of Industry indicates that Jordan recognizes tax-exempt, offshore companies if they conduct their activities outside Jordan and are not

owned by Jordanians.<sup>144</sup> This information indicates that Jordan allows foreign firms to enjoy a Jordanian tax exemption, so long as the foreign firm does not participate in the Jordanian market.

The tax exemption discussed above implicates ORS 317.717(3) and (4). Accordingly, the department recommends that Jordan be included in the list of jurisdictions in ORS 317.716(1)(b).

## **Lebanon**

Lebanon is a country located in the Eastern Mediterranean and is home to approximately 6.1 million people. Arabic is the official language of Lebanon. Growth sectors of the Lebanese economy include banking and tourism.<sup>145</sup>

S corporations reported \$26 million in profits in Lebanon for 2012.<sup>146</sup> Lebanon has a corporate income tax rate of 15 percent. However, Lebanese law does allow a tax exemption for holding companies and offshore companies.<sup>147</sup>

A Lebanese holding company may be owned by non-Lebanese residents and may acquire patents, licenses, and trademarks. The holding company is exempt from the Lebanese corporate income tax, but the holding company is subject to tax on their paid-up capital and reserves.<sup>148</sup>

A Lebanese offshore company may be formed by non-Lebanese residents and is exempt from Lebanese corporate income tax. In return, the company may not participate in the domestic economy of Lebanon. In addition, the activities of the company outside Lebanon are limited.<sup>149</sup>

In addition, the Global Forum has identified a number of shortcomings in Lebanese tax transparency provisions.

First, Lebanon allows the issuance of bearer shares and so the ownership of a Lebanese entity cannot always be identified. Second, in certain circumstances, Lebanese authorities lack the ability to obtain tax information to satisfy a foreign request for information. Third, Lebanese exchange of information treaties do not allow for effective exchange of tax information with foreign nations.<sup>150</sup>

Recently, the Global Forum has announced they will conduct a supplementary review of Lebanon.<sup>151</sup> A supplementary review is performed when a jurisdiction “reports significant improvements” in their exchange of information and tax transparency standards.<sup>152</sup>

In summary, Lebanon does not tax offshore companies that conduct their activities outside Lebanon or holding companies that may not have a substantial connection to Lebanon. This implicates ORS 317.717(3) and (4). Also, Lebanese exchange of information and tax transparency laws do not meet international standards, implicating ORS 317.717(1) and (2). Accordingly, the department recommends that Lebanon be included in the list of jurisdictions in ORS 317.716(1)(b)

## **Liberia**

Liberia is a West African nation with a population of approximately 4,200,000 people. English is the official language of Liberia. Liberia’s economy has traditionally depended on exports of raw materials, such as rubber and timber.<sup>153</sup>

BEA statistics indicate that U.S. corporations reported \$278 million in losses in Liberia during 2013.<sup>154</sup> In general, Liberia taxes corporate income at a 25-percent rate.<sup>155</sup>

The Liberia Fiscal Guide indicates that Liberia taxes the worldwide income of a Liberian resident corporation. However, Liberia taxes only the Liberian source income of a non-resident corporation.<sup>156</sup> A Quick Guide to Taxation in Liberia indicates that a Liberian resident corporation is one that is incorporated in Liberia, and either is managed from Liberia or performs the majority of its operations in Liberia. Also, a company can be considered resident in Liberia if the majority of shareholders reside in Liberia.<sup>157</sup> As a consequence, a company can be incorporated in Liberia without the need for operations in Liberia.

One thing to note is that Liberia exempts shipping income from taxation.<sup>158</sup> As a consequence, Liberia has large presence of Merchant Marines for a nation of its size.<sup>159</sup>

Global Forum report indicated that Liberia lacked sufficient corporate accounting regulations and sufficient records of corporate ownership to be considered compliant with transparency requirements.<sup>160</sup> There is no indication that the Global Forum has changed its evaluation of Liberia's tax transparency provisions.<sup>161</sup>

In summary, foreign-source income is not taxed in Liberia. A foreign corporation does not need a connection to Liberia to take advantage of this tax law. This implicates ORS 317.717(3). Also, Liberia's tax transparency provisions are insufficient, implicating ORS 317.717(2).

### **Liechtenstein**

Liechtenstein is a small country located between Switzerland and Austria with a population of approximately 37,000 people. German is the official language of Liechtenstein. Finance is one of the major industries.<sup>162</sup>

BBEA statistics indicate that U.S. corporations reported \$4 million in losses in Liechtenstein for 2013.<sup>163</sup> Liechtenstein taxes corporate income at a 12.5-percent rate.<sup>164</sup>

However, there are two key provisions of Liechtenstein tax law that reduce the effective rate paid by Liechtenstein corporations. First, *Intellectual Property Box Regimes: Effective Tax Rates and Tax Policy Considerations* indicates that 80 percent of the net income attributable to patents, designs, models, utility models, trademarks, and copyrights (intellectual property) is excluded from Liechtenstein corporate income tax. It also indicates that this intellectual property tax exemption applies to acquired or developed intellectual property. Also, past research and development costs must be recaptured and added to intellectual property income.<sup>165</sup> Please note, Liechtenstein may phase out its intellectual property tax exemption by 2020.<sup>166</sup>

Second, Liechtenstein corporations are allowed to deduct 4 percent of their weighted equity value against their income. This is referred to as a "notional interest deduction."<sup>167</sup> Typically, corporations are allowed to deduct interest they pay on their debts while they are not allowed to deduct dividends paid. One economic justification for a notional interest deduction is to remove the tax preference that favors debt over equity.<sup>168</sup> It is possible that a Liechtenstein corporation holding intellectual property pays a zero effective tax rate, even if their weighted equity value equals their net income.

In summary, there is no evidence that a company needs to have a substantive connection to Liechtenstein to take advantage of the Liechtenstein tax system. This implicates ORS 317.717(3).

### **Luxembourg**

Luxembourg is a nation located between Belgium and Germany with a population of approximately 570,000 people. French, German, and Luxembourgish are the official languages. Financial services are the largest part of Luxembourg's economy.<sup>169</sup>

U.S. corporations reported \$111.468 billion in profits in Luxembourg during 2013.<sup>170</sup> Luxembourg has a headline corporate tax rate of 20 percent for the first 15,000 euros of taxable income and 21 percent for any taxable income in excess of 15,000 euros.<sup>171</sup>

Media coverage has focused on Luxembourg's role in various tax avoidance schemes.<sup>172</sup> The 2000 OECD report indicated that Luxembourg operated a preferential tax regime due to the Luxembourg 1929 Holding Company legislation.<sup>173</sup> This legislation has since been repealed.<sup>174</sup>

*Luxembourg—A Hub for Intellectual Property* indicates that Luxembourg exempts 80 percent of net income or capital gains attributed to the use or right to use patents, trademarks, or copyrights (intellectual property) acquired from a third party. Eighty percent of the income from self-developed intellectual property is excluded from Luxembourg income tax. The research and development for the intellectual property can occur outside Luxembourg. Income from intellectual property may be excluded from tax only if the intellectual property was acquired or developed after 2007.<sup>175</sup>

Please note, Luxembourg is phasing out its partial tax exemption for intellectual property. However, a "grandfather clause" provision continues the exemption until 2021 for current beneficiaries.<sup>176</sup>

In addition, Luxembourg differentiates between resident and non-resident companies. A resident company has their registered office or central administration in Luxembourg, whereas a non-resident company has their registered office or central administration outside Luxembourg. Luxembourg resident companies are taxed on their worldwide income while Luxembourg non-resident companies are only taxed on their Luxembourg source income.<sup>177</sup>

A Global Forum report indicated that Luxembourg failed to enforce its exchange of information and tax transparency laws. Namely, Luxembourg does not use its legal powers to obtain taxpayer information, or enable effective exchange of information with other jurisdictions. Also, Luxembourg does not have sufficient laws to provide for transparency of company ownership information.<sup>178</sup> However, the Global Forum has updated Luxembourg's status regarding effective exchange of tax information and transparency of tax information provisions to largely compliant with international standards.<sup>179</sup>

Also, the profits reported by U.S. corporations in Luxembourg are greater than the entire GDP of Luxembourg. In addition, most banks in Luxembourg are foreign-owned and financial sector accounts for 36 percent of GDP.<sup>180</sup> The offshore financial center in Luxembourg is subject to no or nominal tax and constitutes a large part of the Luxembourg economy. Accordingly, Luxembourg has created a tax regime favorable for tax avoidance.

In summary, Luxembourg taxes large categories of corporate income at a nominal rate due to its tax treatment of intellectual property, and the exclusion of the foreign source income of a non-resident Luxembourg company from Luxembourg tax. A Luxembourg company can seek this advantageous tax treatment without a substantial connection to Luxembourg. This implicates ORS 317.717(3). Also, Luxembourg has created a tax regime favorable for tax avoidance, implicating ORS 317.717(5).

## **Macau**

Macau is a special administrative area of China with its own legal system. Macau has a population of approximately 592,000 people. Macau is a noted center of the world's gaming industry.<sup>181</sup>

BEA statistics indicate that U.S. corporations claimed \$3.588 billion in profits in Macau during 2012.<sup>182</sup> Macau's corporate income tax is 12 percent.<sup>183</sup>



Macau does have an offshore company regime for financial and non-financial institutions. Article 4 of the Offshore Regime of Macau provides that a Macau offshore company cannot carry on activities with residents of Macau. Article 12 provides the Macau offshore company an exemption from Macau income tax. Article 5 provides that the Macau offshore company is a company incorporated in Macau or the branch of a company incorporated in a place other than Macau.<sup>184</sup>

In summary, Macau offers a tax exemption for foreign companies while preventing the tax-exempt company from taking part in the domestic market of Macau. This implicates ORS 317.717(4). Accordingly, the department recommends that Macau be included in the list of jurisdictions at ORS 317.716(1)(b).

## **Malta**

Malta is an island in the Mediterranean Sea, located between Sicily and Libya, with a population of approximately 413,000 people. Malta's official languages are English and Maltese. Financial services, manufacturing, trade, and tourism are significant economic activities in Malta.<sup>185</sup>

U.S. corporations reported \$330 million in profits in Malta during 2013.<sup>186</sup> Malta has a corporate income tax rate of 35 percent. Any company incorporated in Malta is considered tax resident in Malta.<sup>187</sup> However, Section 3 of the Legal Notice 429 of 2010 provides that royalties received on patents are exempt from Maltese corporate income tax. There is no requirement that research leading to the patent be performed in whole or in part in Malta.<sup>188</sup>

In summary, Malta has an effective tax rate of zero on patent royalty receipts. There is no requirement that the Maltese company holding the patent have a substantive connection to Malta, or that any research for the patent needs to be performed in Malta. This implicates ORS 317.717(3).

## **Marshall Islands**

The Marshall Islands is located in the Pacific Ocean with a population of approximately 72,000 people. English and Marshallese are the official languages. Agriculture is the main industry of the Marshall Islands.<sup>189</sup>

BEA statistics indicate that U.S. corporations reported \$94 million in losses in the Marshall Islands during 2013.<sup>190</sup> The Marshall Islands has a business gross revenue tax of 3 percent, per Section 109 of the Marshall Islands Income Tax Act.<sup>191</sup>

Section 12 of the Marshall Islands Business Corporations Act provides that a non-resident domestic corporation is exempt from tax and fees, aside from incorporation and annual registration fees. Section 2(c) of the act defines a domestic corporation as a corporation formed in the Marshall Islands. A non-resident corporation, according to Section 2(i) of the act, is a corporation not doing business in the Marshall Islands. Furthermore, Section 2(o) of the act allows for a wide spectrum of activities to be performed in the Marshall Islands, including maintaining a bank account and office, before the corporation is considered to be doing business in the Marshall Islands.<sup>192</sup>

Global Forum report indicated that the Marshall Islands lacked sufficient corporate accounting regulations and sufficient records of corporate ownership to comply with transparency requirements.<sup>193</sup> However, the Global Forum has noted improvement in the Marshall Islands' corporate accounting regulations. A new Global Forum report on the Marshall Islands will be available December 19, 2016.<sup>194</sup>

In summary, the Marshall Islands exempt corporations not doing business in the Marshall Islands from tax. Also, corporations not resident in the Marshall Islands enjoy the exemption from Marshall Islands tax if they

do not take part in the Marshall Islands economy. This implicates ORS 317.717(3) and (4). Also, the Marshall Islands' tax transparency provisions are insufficient, implicating ORS 317.717(2).

## **Mauritius**

Mauritius is an island nation located in the Indian Ocean near Madagascar with a population of approximately 1.3 million people. English, French, and a creole language mostly based on French, are spoken. Mauritius' economy is based on tourism, textiles, sugar, and financial services.<sup>195</sup>

BEA statistics show that U.S. corporations reported \$1.216 billion in profits in Mauritius during 2013.<sup>196</sup> Corporate income is taxed at 15 percent.<sup>197</sup>

In Part 1, Section 19 of the Second Schedule of the Mauritius Income Tax Act indicates that corporations holding a Category 2 Global Business License are exempt from Mauritius tax. Also, Section 76 of the same act indicates that corporations holding this license are not resident on Mauritius for tax purposes.<sup>198</sup>

Section 71(1) of the Mauritian Financial Services Act provides that a Mauritian resident corporation may apply for a global business license to conduct business outside Mauritius. This implies that a Category 2 Mauritius Global Business Licensee may not participate in the Mauritian domestic market because Section 71(6) indicates that only firms holding Category 1 Global Business Licenses may participate in the Mauritian domestic market.<sup>199</sup>

Section 71(3) of the Mauritian Financial Services Act provides that a Mauritian resident corporation cannot apply for a Category 2 Global Business License, unless the corporation is a private company and carries out activities other than those listed in the Fourth Schedule of the Financial Services Act.<sup>200</sup>

Section 71(7) states that resident corporations include corporations that are incorporated or registered in Mauritius.<sup>201</sup> A private company, according to Section 2 of the Mauritian Companies Act, is a company incorporated or registered in Mauritius that has characteristics described in Part 21 of the Mauritian Companies Act.<sup>202</sup> Section 270 of the Mauritian Companies Act describes those characteristics. Most prominently, a Mauritian private company may have no more than 25 shareholders.<sup>203</sup>

The Fourth Schedule of the Mauritian Financial Services Act covers the following activities: banking, holding companies, financial services, providing registered office services to corporations, and trusteeship operations.<sup>204</sup>

However, there is no indication that similar restrictions that are applicable to resident Mauritian corporations seeking a Category 2 Global Business License are also applicable to non-resident Mauritian corporations. Also, Section 73(2) of the Mauritius Financial Services Act prevents the holder of a Category 2 Global Business License from seeking substantial connections with Mauritius.<sup>205</sup>

In summary, a corporation incorporated in Mauritius is exempt from tax if it is a non-resident corporation or meets the qualifications of a private company and conducting business outside Mauritius while being excluded from the Mauritian domestic market. Also, the holder of a Category 2 Global Business License is prevented from having a substantial connection with Mauritius. This implicates ORS 317.717(3) and (4).

## **Montserrat**

Montserrat is a Caribbean overseas territory of the U.K. with a population of approximately 5,000 people. English is the official language of Montserrat. Construction and government services are the main industries.<sup>206</sup>

There is no information indicating how much U.S. companies profited specifically in Montserrat. However, other statistics indicate that U.S. corporations reported \$39.639 billion in profits during 2012 in Caribbean islands belonging to the U.K.<sup>207</sup> Montserrat has a corporate income tax rate of 30 percent, according to Section 37 of the Montserrat Income and Incorporation Tax Act.<sup>208</sup>

However, Montserrat allows the incorporation of international business companies. Section 5 of the Montserrat International Business Company Act provides that an international business company established under the act may not carry on business in Montserrat. Section 111 of the Montserrat International Business Companies Act provides that a Montserrat international business company is exempt from tax for a period of at least 25 years.<sup>209</sup>

In summary, companies that are tax-exempt are excluded from the domestic market of Montserrat and are prevented from establishing a substantial connection to Montserrat. This implicates ORS 317.717(3) and (4).

### **Nauru**

Nauru is an island located in the Southern Pacific Ocean with a population of approximately 9,500 people. English and Nauruan are the primary languages. Nauru's economy is dependent on assistance from Australia.<sup>210</sup>

BEA statistics do not show any profits reported by U.S. corporations in Nauru.<sup>211</sup> Nauru does not have a corporate income tax.<sup>212</sup>

It appears that Nauru's reputation as a listed jurisdiction dates back to the 1990s when a Nauruan bank could be set up for \$25,000. These banks were not required to keep records. Concerns about money laundering grew as a result of the lax banking environment.<sup>213</sup> All banks on Nauru were shut down in 2006.<sup>214</sup>

In the report *Tax Transparency 2013*, the Global Forum found that Nauru has insufficient exchange of information provisions and tax transparency provisions related to accounting regulations and company ownership information.<sup>215</sup> Currently, the Global Forum is performing a supplementary review of Nauru.<sup>216</sup>

In summary, Nauru has no corporate income tax. Also, Nauru's provision for exchange of information is deficient and the Nauru tax system lacks transparency. This implicates ORS 317.717(1) and (2).

### **Niue**

Niue is located in the middle of the South Pacific Ocean with a population of approximately 1,200 people. Niuean and English are the official languages of Niue. Niue's economy is centered on government and subsistence agriculture.<sup>217</sup>

BEA statistics do not show any profits reported by U.S. corporations in Niue.<sup>218</sup> Niue has a corporate income tax rate of 30 percent.<sup>219</sup>

Niue used to have an International Business Company Act that exempted Niue corporations from tax if they didn't conduct business within Niue.<sup>220</sup> Niue repealed their International Business Companies Act in 2006, per Section 349 of the Companies Act.<sup>221</sup> Section 49 of the Niue Income Tax Act exempts some trust income and other types of company income.<sup>222</sup> Trusts are not incorporated entities and fall outside the scope of ORS 317.716.

Section 49(p) of the act exempts the income of life insurance companies, if the insurance company income comes from life insurance premiums. Section 72(1) of the act provides that overseas insurance companies are

taxable on their Niue source income, except for life insurance premiums. Section 49(d) states that Niue does not tax dividends from companies subject to income tax.<sup>223</sup>

2014 Global Forum table of determinations notes that Niue does not require its corporations to keep accounting records unless the corporation has Niue-source income or does business in Niue.<sup>224</sup> However, the Global Forum has deemed Niue to be largely compliant with international tax transparency standards.<sup>225</sup>

In summary, the income of life insurance companies from outside Niue is exempt from taxation and there is no indication the recipient of the life insurance income has to have a substantial connection to Niue to benefit from the exemption. This implicates ORS 317.717(3).

### **Saba**

Saba is a Caribbean Island under the direct administration of the Netherlands.<sup>226</sup> Saba's population is approximately 1,800.<sup>227</sup> The main language in Saba is Dutch.<sup>228</sup> The main industry is tourism.<sup>229</sup>

U.S. corporations reported \$7 million of profits in the Netherlands Islands in the Caribbean during 2013.<sup>230</sup>

Corporations in Saba are subject to a 5-percent distribution tax that is imposed on proceeds from shares. A corporation that performs group financing or licensing activities must have at least three employees and had have an office in Bonaire, Saba, or Sint Eustatius.<sup>231</sup>

In summary, Saba allows the establishment of companies without the need for a substantial tie to Saba. This implicates ORS 317.717(3).

### **St. Kitts and Nevis**

St. Kitts and Nevis is an island nation in the Caribbean, with a population of approximately 52,000 people. English is the main language of St. Kitts and Nevis. The main industries include agriculture, light manufacturing, and tourism. St. Kitts and Nevis was formerly known as St. Christopher and Nevis.<sup>232</sup>

No statistics relating to U.S. corporations' profit in St. Kitts and Nevis was released for 2013, to avoid disclosing information related to particular companies.<sup>233</sup> St. Kitts and Nevis has a corporate tax rate of 33 percent.<sup>234</sup>

Section 224 of the St. Kitts and Nevis Companies Act gives tax-exempt status to a St. Kitts and Nevis company that conducts no business with residents of St. Kitts and Nevis.<sup>235</sup>

In summary, companies are exempt from tax and not allowed to compete in the St. Kitts and Nevis domestic market. This implicates ORS 317.717(4).

### **St. Lucia**

St. Lucia is an island in the Caribbean between Puerto Rico and South America with a population of approximately 164,000 people. English is the official language. Offshore banking and tourism are important industries.<sup>236</sup>

BEA statistics show that U.S. corporations reported \$74 million in profits in St. Lucia during 2013.<sup>237</sup> St. Lucia has a corporate income tax rate of 30 percent.<sup>238</sup>

St. Lucia has passed an International Business Company Act. Section 12 of this act prevents an international business company established under the act from conducting business with residents of St. Lucia. Section

109 of the act exempts international business companies from tax. Section 109 also indicates that a St. Lucian international business company may elect to pay a 1 percent income tax.<sup>239</sup>

In summary, St. Lucia imposes no or nominal taxes on international business companies. St. Lucia also prevents international business companies from taking part in the domestic market of St. Lucia. This implicates ORS 317.717(4).

### **St. Vincent and the Grenadines**

St. Vincent and the Grenadines is a chain of islands located in the Caribbean Sea near South America with a population of approximately 103,000 people. English and a French patois are spoken here. Farming and tourism are the main industries.<sup>240</sup>

U.S. corporations reported \$1 million in losses in St. Vincent and the Grenadines during 2013.<sup>241</sup> St. Vincent and the Grenadines has a corporation tax rate of 32.5 percent.<sup>242</sup>

The St. Vincent and the Grenadines' International Business Company Act exempts an international business company from tax if the international business company does no business with residents of St. Vincent and the Grenadines. Section 180(2) of the act provides an option of paying a 1 percent tax, in lieu of the tax exemption.<sup>243</sup>

In summary, nominal taxation is imposed on an international business company and the international business company is not allowed to participate in the St. Vincent and the Grenadines economy. This implicates ORS 317.717(4).

### **Samoa**

Samoa is an island nation in the South Pacific with a population of approximately 197,000 people. English and Samoan are languages spoken on Samoa. Samoa's economy is reliant on agriculture, development aid, and foreign remittances.<sup>244</sup>

BEA statistics indicate that U.S. corporations reported \$1 million in profits in Samoa during 2013.<sup>245</sup> Samoa has a corporate tax rate of 27 percent.<sup>246</sup>

Samoa enacted an International Companies Act. Section 6 of the act expressly forbids residents or domestic corporations of Samoa (with the exception of trust companies) from holding an interest in a Samoan international company. Section 249(4)(a) of the same act provides that a Samoan international company may not carry on business with persons ordinarily resident in Samoa. Section 249(2)(a) of the act provides that a Samoan international company is exempt from all taxes and stamp duty for non-Samoan source income.<sup>247</sup>

In summary, Samoan international companies are not subject to tax. Samoan companies or residents may not own Samoan international companies and these companies may not do business in the Samoan domestic market. This implicates ORS 317.717(4).

### **San Marino**

San Marino is a small country high in the mountains of Central Italy with a population of approximately 33,000 people. Italian is spoken in San Marino. Important industries include agriculture, banking and manufacturing.<sup>248</sup>

BEA statistics include San Marino, but these statistics do not show whether American firms reported any profit or loss in San Marino.<sup>249</sup> Currently, San Marino's corporate income tax rate is 17 percent.<sup>250</sup>

An International Monetary Fund report indicated that Italians used San Marino banks for tax avoidance. Eventually, Italy placed San Marino on a “blacklist” due to the country’s refusal to turn over banking information to Italian authorities.<sup>251</sup> In February 2014, Italy removed San Marino from its blacklist.<sup>252</sup> A 2014 IMF report states that San Marino has lost half its deposits in the last few years due to the actions of the Italian government.<sup>253</sup>

One source indicates San Marino’s tax rate for corporations can be as low as zero, due to the holdings for intellectual property and providing intra-group services.<sup>254</sup> There is no evidence a company needs to have a substantial presence within San Marino to take advantage of the San Marino tax regime. In fact, it is questionable to what degree a company could establish a substantial presence in San Marino given the country’s small size.

In summary, San Marino’s tax rate on intellectual property holding companies and intra-group services vary between 0 and 6.5 percent, and there is no evidence of a substantial presence needed in San Marino to take advantage of the tax regime. This implicates ORS 317.717(3).

### **Seychelles**

Seychelles is an island nation located in the Indian Ocean, far off the east coast of Africa, with a population of approximately 92,000 people. English, French, and Seychellois creole are the official languages of Seychelles. Main industries in Seychelles include farming, fishing, and tourism.<sup>255</sup>

BEA statistics indicate that U.S. corporations reported between \$500,000 in losses and \$500,000 in profits in Seychelles during 2013.<sup>256</sup> Seychelles taxes corporate income at a maximum rate of 33 percent.<sup>257</sup>

Section 5 of the Seychelles International Business Companies Act prevents a company incorporated under the act from carrying on business in Seychelles. Section 109(1) and (2) of the same act provide for exemptions from payment of tax and stamp duty for Seychelles international business companies.<sup>258</sup>

A Global Forum report indicated that Seychelles failed to enforce its tax transparency laws. Namely, Seychelles fails to provide effective regulations or sanctions to ensure that company ownership information is available. Also, Seychelles does not monitor companies to ensure companies are abiding by accounting regulations.<sup>259</sup>

However, the Global Forum currently deems Seychelles to be “largely compliant” with international tax transparency standards. It should be noted that the Global Forum deems jurisdictions to be compliant, largely compliant, partially compliant, or non-compliant after the jurisdiction undergoes a Phase 2 review by its international peers. It follows that the Seychelles, unlike in previous years, meets the standards set forth in ORS 317.717(2).<sup>260</sup>

In summary, international business companies incorporated in Seychelles are exempt from tax, while being excluded from the domestic market of Seychelles and prevented from establishing a substantive presence in Seychelles. This implicates ORS 317.717(3) and (4).

### **Sint Eustatius**

Sint Eustatius is a Caribbean Island under the direct administration of the Netherlands.<sup>261</sup> Sint Eustatius’ population is approximately 19,000.<sup>262</sup> The main language in Sint Eustatius is Dutch.<sup>263</sup> The main industry in is tourism.<sup>264</sup>

U.S. corporations reported \$7 million in profits in the Netherlands Islands, Caribbean during 2013.<sup>265</sup>

Corporations in Sint Eustatius are subject to a 5-percent distribution tax that is imposed on proceeds from shares. A corporation that performs group financing or licensing activities must have at least three employees and had have an office in Bonaire, Saba, or Sint Eustatius.<sup>266</sup>

In summary, Sint Eustatius allows the establishment of companies without the need for a substantial tie to Sint Eustatius. This implicates ORS 317.717(3).

### **Sint Maarten**

Sint Maarten is an independent nation located in the Caribbean with a population of approximately 148,000 people. Dutch, English and Papiamentu are spoken in Sint Maarten.<sup>267</sup>

BEA statistics for 2013 related to the amount of profits reported by U.S. corporations in Sint Maarten were suppressed to avoid disclosing the identity of individual companies.<sup>268</sup> Sint Maarten taxes corporate income at 30 percent.<sup>269</sup> However, Sint Maarten allows for the establishment of an exempt company. However, an exempt company must limit its activities to financial investments and the licensing of intellectual property.<sup>270</sup>

In summary, Sint Maarten allows the establishment of tax-exempt companies that may not participate in the domestic market of Sint Maarten. This implicates ORS 317.717(4).

### **Trinidad and Tobago**

Trinidad and Tobago is a Caribbean island nation with a population of approximately 1,200,000 people. English is the official language of Trinidad and Tobago. Energy is a mainstay of the Trinidad and Tobago economy.<sup>271</sup>

BEA statistics show that U.S. corporations reported \$998 million in profits in Trinidad and Tobago during 2013.<sup>272</sup> Trinidad and Tobago has a corporate tax rate of 25 percent.<sup>273</sup>

Trinidad and Tobago determines corporate residency with respect to where the corporation is managed or controlled. Resident companies are taxed on their worldwide income. Non-resident are only taxed on their Trinidad and Tobago source income.<sup>274</sup> Accordingly, a company can be incorporated in Trinidad and Tobago and pay zero tax if the income of the company is sourced outside of Trinidad and Tobago.

There are also issues with Trinidad and Tobago's exchange of information provisions. For example, a presidential order is required for Trinidad and Tobago to share tax information with another jurisdiction. Trinidad and Tobago has been determined to be non-compliant with internationally accepted exchange of information standards.<sup>275</sup> There is no evidence the Global Forum has changed their evaluation of Trinidad and Tobago's exchange of information provisions.<sup>276</sup>

In summary, Trinidad and Tobago has a tax rate of zero on foreign source income for non-resident companies and lacks effective exchange of information provisions. This implicates ORS 317.717(1).

### **Turks and Caicos Islands**

The Turks and Caicos Islands is a U.K. overseas territory located in the Caribbean with a population of approximately 50,000 people. English is the official language of the Turks and Caicos Islands. The main industries are financial services and tourism.<sup>277</sup>

There is no specific information on how much profit U.S. corporations earn in the Turks and Caicos Islands. However, other statistics indicate that U.S. corporations reported \$57.018 billion in profits during 2013 in Caribbean islands belonging to the U.K.<sup>278</sup> The Turks and Caicos Islands do not tax corporate income.<sup>279</sup>

The Turks and Caicos Companies Ordinance provides for the establishment of exempted companies. Moreover, the Turks and Caicos Companies Ordinance provides for the establishment of companies that can take advantage of the Turks and Caicos tax system without a substantive presence in the islands.<sup>280</sup>

Section 189 of the ordinance provides that exempted companies must carry out most of their activities outside the Turks and Caicos Islands. Section 202 provides that trade by an exempted company is forbidden within the Turks and Caicos Islands, unless the trade is minor or ancillary to trade carried on outside the Turks and Caicos Islands.<sup>281</sup>

Section 209 of the ordinance provides that an exempt company is exempt from tax for a period of 20 years.<sup>282</sup>

Also, it has been noted that the Turks and Caicos' economy is based, in part, on offshore financial services.<sup>283</sup> It follows that the Turks and Caicos' untaxed offshore financial services industry is significant part of the Turks and Caicos economy. Accordingly, the Turks and Caicos Islands has created a tax regime favorable for tax avoidance.

In summary, there is a zero tax rate for exempt companies for a period of 20 years. An exempt company has no need to establish a substantial presence in the Turks and Caicos domestic market. In fact, such a presence is prohibited by law. This implicates ORS 317.717(3) and (4). Additionally, the Turks and Caicos Islands possess a significant untaxed offshore financial services sector, implicating criterion 5.

### **United Arab Emirates**

The United Arab Emirates is a nation located in the Persian Gulf and home to approximately 5.8 million people. Arabic is the official language of the United Arab Emirates. Oil is the leading industry of the United Arab Emirates, although tax-exempt free zones in the United Arab Emirates attract foreign investment.<sup>284</sup>

U.S. corporations reported \$2.803 billion in profits in the United Arab Emirates during 2013.<sup>285</sup> The United Arab Emirates imposes a 20-percent corporate income tax on banks and a 50 to 55 percent tax on oil companies.<sup>286</sup>

The United Arab Emirates has established "free zones" where special incentives are given to businesses to operate within the free zone. A company owned entirely by foreigners may be established inside the free zone. A company inside the free zone may be incorporated in the United Arab Emirates or founded as a branch of a foreign corporation. The foreign company inside the free zone is tax exempt, but it may not participate in the economy of the United Arab Emirates.<sup>287</sup>

In summary, the United Arab Emirates allows the establishment of offshore companies that may not participate in the economy of the United Arab Emirates. This implicates ORS 317.717(3) and (4). Accordingly, the department recommends that the United Arab Emirates be included in the list of jurisdictions at ORS 317.716(1)(b).

### **U.S. Virgin Islands**

The U.S. Virgin Islands (USVI) is a U.S. territory located in the vicinity of Puerto Rico, with a population of approximately 104,000. English is the main language of the USVI and tourism is the main economic activity.<sup>288</sup>

No statistics are available on how much profit U.S. corporations reported in the U.S. Virgin Islands.<sup>289</sup> The U.S. Virgin Islands have a corporate tax rate of 35 percent.<sup>290</sup>



USVI operates a system of taxation that “parallels” the U.S. tax system.<sup>291</sup> Typically, a U.S. citizen with income from the USVI has to fill out two separate tax returns unless that person is a bona fide resident of the U.S. Virgin Islands.<sup>292</sup>

USVI operates an exempt company regime. 13 V.I.C. 851(a) provides that an exempt company is a corporation organized in the U.S. Virgin Islands. 13 V.I.C. 852(1)<sup>293</sup> states that a USVI exempt company cannot carry on business within the United States unless the corporation is an exempt insurer that is a domestic corporation per I.R.C. 7701(a)(3) and (4) or has made an election under I.R.C. 953(d). An exempt insurer is a company that meets the definition of “exempt international insurer” in 22 V.I.C. 1401(l).<sup>294</sup>

22 V.I.C. 1401(L) defines an exempt international insurer as any international insurance company that makes an election under 22 V.I.C. 1415. An international insurance company, per 22 V.I.C.1401(t), is a company that insures risks outside the U.S. Virgin Islands. 22 V.I.C. 1415(a) provides for an election by an international insurance company to be treated as an Exempt Company.<sup>295</sup>

Therefore, it is possible for a U.S. corporation to form an exempt corporation under USVI law if the insurer only insures risks outside the U.S. Virgin Islands. Furthermore, the U.S. corporation formed in the USVI is not included in the U.S. consolidated group.<sup>296</sup>

These laws may result in tax avoidance due to the existence of captive insurance companies. A captive insurance company is an insurance company that is owned by a corporate group and only insures that corporate group. It follows that the use of a captive insurance company could lead to tax avoidance if the premiums paid to the captive insurance by the corporate group are overpriced.<sup>297</sup>

In summary, captive insurers are exempt from taxation, and are not allowed to compete in the U.S. Virgin Islands insurance market. This implicates ORS 317.717(4).

## **Vanuatu**

Vanuatu is a nation located in the Pacific Ocean with a population of approximately 272,000 people. Bislama, French, and English are the official languages. Agriculture, cattle, financial services, fishing, and tourism are prominent industries in Vanuatu.<sup>298</sup>

U.S. corporations reported \$9 million in profits in Vanuatu during 2013.<sup>299</sup> Vanuatu does not have a corporate income tax.<sup>300</sup>

Section 10 of the Vanuatu International Companies Act prevents an international company from carrying on business within Vanuatu. However, Section 118 provides that the Vanuatu international company is exempt from all Vanuatu fees, stamp duties, and taxes.<sup>301</sup>

A Global Forum report indicated that Vanuatu lacked the following exchange of information and tax transparency provisions:

- Sufficient corporate accounting regulations.
- Sufficient mechanism to require disclosure of information by taxpayers.
- Sufficient exchange of information provisions.
- Sufficient exchange of information network with all relevant partners.<sup>302</sup>

Currently, Vanuatu is undergoing a supplementary review by the Global Forum.<sup>303</sup> A supplementary review is performed when a jurisdiction “reports significant improvements” in their exchange of information and tax transparency standards.<sup>304</sup>

In summary, foreign income is not taxed, the corporation enjoying the lack of taxation on foreign sourced income is prevented from competing in the Vanuatu domestic market, and the corporation does not need a substantial connection to Vanuatu. This implicates ORS 317.717(3). Also, Vanuatu's exchange of information and tax transparency provisions are insufficient, implicating ORS 317.717(1) and (2).

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<sup>1</sup> United States. Central Intelligence Agency. "Andorra." *The World Factbook*. cia.gov. 1 Aug 2016 Web. 16 Aug.2016.

<sup>2</sup> United States; Dept. of Commerce; Bureau of Economic Analysis; International Data Direct Investment and MNE; Financial and Operating Data, U.S. Direct Investment Abroad, All Majority-owned Foreign Affiliates (data for 2009 and forward), Net Income by Country Only (All Countries) (Millions of Dollars); U.S. Dept. of Commerce, 5 Aug. 2016; Web. 5 Aug. 2016.

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# Appendix 2

## Letters of concern

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Ambasáid na hÉireann  
Embassy of Ireland  
Washington DC

7 September 2016

Mr. Jason M. Larimer  
Policy Coordinator,  
Oregon Department of Revenue,  
Corporation/Estate Section – Business Division  
955 Center St NE,  
Salem, OR 97301-2555

**Re: Consideration of “Listed jurisdictions” under Oregon law**

Dear Mr. Larimer,

I am writing to you on behalf of the Government of Ireland and I wish to thank you for your letter, dated August 8 2016, in which you draw to my attention the work of the Oregon Department of Revenue concerning the preparation of a report to the Oregon Legislative Assembly as provided for under Oregon law (namely Oregon Revised Statutes (ORS) 317.717), concerning “listed jurisdictions”.

The Government of Ireland appreciates the opportunity to input at this stage into the reflections of the Oregon Department of Revenue concerning recommendations as regards possible revisions to the list of “listed jurisdictions” set out in Oregon law (ORS 317.716(1)(b)). We note that the next Oregon Department of Revenue report concerning “listed jurisdictions” to the Oregon Legislative Assembly, as required under Oregon law (ORS 317.717), is to be submitted on or before January 1 2017.

As you note in your letter the “listed jurisdictions” as set out in Oregon law (ORS 317.716(1)(b)) are commonly known as “tax havens”. The Government of Ireland is surprised and disappointed to learn that the Oregon Department of Revenue could consider Ireland to be a “tax haven”. We consider any such suggestion to be entirely groundless and would have no State, Federal or international precedent.

Ireland is not a “tax haven” and as outlined in more detail below, Ireland does not meet the criteria in ORS 317.717 to be included as a “listed jurisdiction”. Ireland is in full compliance with all applicable international standards and frameworks and has a longstanding Tax Treaty/Double Taxation Agreement in place with the United States to facilitate the exchange of information and cooperation between US and Irish tax authorities. Moreover, Ireland signed up to the OECD Base Erosion and Profit Shifting (BEPS) recommendations of October 2015 and we have been an early mover in implementing those recommendations, such as country by country reporting, which has already been implemented in Irish domestic law.

Ireland has also been fully engaged in the ongoing work at the European Union level to deal with these issues. As recently as June 2016, Ireland together with our European Union partners agreed the Anti-Tax Avoidance Directive. This Directive introduces five significant corporate tax anti-avoidance measures, the first three of which (relating to controlled foreign company rules, interest limitation rules; and hybrid mismatch rules) directly seek to implement OECD BEPS recommendations, while the other two measures relate to an exit tax and a general anti-avoidance rule.

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Under ORS 317.717 when considering inclusion as a “listed jurisdiction”, a two stage test applies and both tests must be failed for a country to fall foul of the legislation. First, it must be determined whether a jurisdiction is one that for the tax year has no or nominal effective tax on the relevant income **and** secondly, at least one of the other criterion must apply.

In relation to the first test, Ireland is not a nominal-tax or a no-tax jurisdiction. We have a corporate tax rate of 12.5% which is statute-based and applied transparently to domestic and international companies. This is not the lowest corporate tax rate even within the European Union. A 12.5% rate is not a nominal amount. Given Ireland’s transparent, statute-based corporate tax rate of 12.5%, Ireland does not meet this essential criteria to be a “listed jurisdiction” under Oregon law.

While the statutory requirement is that a jurisdiction must meet both the tax rate test and the other information and transparency tests to be considered a “listed jurisdiction” and Ireland’s 12.5% corporate tax should end the inquiry, we provide the following responses to the letter regarding the additional criteria.

In relation to the second test under ORS 317.717, we note that you raise criterion 3 of Oregon’s “listed jurisdiction” law, namely that “The jurisdiction facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy”. We note also that you refer to the provisions of the Irish Finance Act 2014 and incorrectly state that companies can remain “stateless” under Irish residence rules until 2020.

There have been two significant changes to Ireland’s corporate tax residence rules in recent years. Finance Act (No. 2) 2013 amended our company residence rules to ensure that a company incorporated in Ireland cannot be regarded as not being resident anywhere as a result of the differences between Ireland’s corporate residence rules and those of a country with which we have a tax treaty. This change ensures that no Irish incorporated company can be “stateless” and this change applies to all companies currently (and has not been delayed until 2020 as suggested in your letter).

Ireland’s rules in relation to company tax residence were also significantly revised in the Finance Act 2014. Section 43 of Finance Act 2014 provides that a company incorporated in Ireland will be regarded as resident for tax purposes in Ireland, unless it is treated as resident in a treaty partner country by virtue of a double taxation treaty. Of central importance to these significant changes to Ireland’s company residence rules is that the new incorporation rules for determining the tax residence of a company incorporated in Ireland have applied to all companies incorporated on or after January 1 2015. In the case of companies incorporated in Ireland before January 1 2015, a transition period (which is common international practice when a major revision to corporation tax rules are being introduced) will apply until the end of 2020. This is a separate change to the change made in the prior year targeting “stateless” companies. The purpose of this subsequent reform was to prevent companies from operating an identified structure which was being used to exploit gaps in the United States Subpart F rules.

As pointed out above, Ireland’s changes to prevent a company from being “stateless” applies to all companies incorporated in Ireland without exception. Thus the argument set out in your letter does not apply and Ireland clearly and emphatically, is not a jurisdiction that “facilitates the establishment of foreign-owned entities without the need for a local substantive presence”. On the contrary, Ireland’s statute law, since the beginning of 2015, provides explicitly that any company incorporated in Ireland will be regarded as resident for tax purposes in Ireland unless it is tax resident in a treaty partner country by virtue of a double taxation treaty. Criterion 3 of Oregon’s “listed jurisdiction” law (ORS 317.717) thus does not apply in the case of Ireland.



It should be noted also that Ireland is not in any sense a tax secrecy jurisdiction. Ireland supports the automatic exchange of information between tax authorities as an important tool in the fight against tax fraud and evasion. For that reason we were one of the first countries in the world to conclude an international agreement with the United States on the implementation of the Foreign Account Tax Compliance Act (FATCA) in December 2012. Additionally, as of October 2015, the Global Forum on Transparency and Exchange of Information for Tax Purposes assessed Ireland as being one of only twenty two jurisdictions which attained its top rating of “Compliant”. The Global Forum is the leading international body carrying out peer reviews of countries’ compliance with international best practice on the exchange of tax information. Furthermore, Ireland has fully implemented the OECD Common Reporting Standard for Automatic Exchange of Financial Account Information, which was inspired by the FATCA. Ireland has also signed up, and implemented, a number of EU Directives providing for comprehensive exchange of information among EU Member States.

Ireland does not seek to attract brass-plate investments to Ireland, but substantive operations of US and other global companies. Many of these operations service the vast EU market of more than 500 million people, as well as international markets beyond Europe. US companies employ more than 100,000 Irish people in these high value operations, critical to their global success.

In return Irish companies employ tens of thousands of Americans across all 50 States, including Oregon. In 2015, Ireland was the 15<sup>th</sup> largest international market for exports from Oregon and the fourth largest European export market for the State of Oregon.

Ireland was the 6<sup>th</sup> largest source of international investment into the United States in 2015 and importantly, Ireland was also the 10<sup>th</sup> fastest growing source of foreign direct investment into the United States last year.

As Ireland’s single largest export market for goods in 2015, the US consumed 24% of our goods exports. The US is also Ireland’s largest trading partner in international traded services, with total trade in services amounting to almost €37 billion (almost \$42 billion) in 2014. This trading relationship is also significant for the US, with Ireland standing as the 11<sup>th</sup> largest source of imports of goods into the United States, for the year up to June 2016 and the 14<sup>th</sup> largest trading partner of the United States in good, over the same period. The bilateral trade and investment relationship which exists between the US and Ireland is deep, multifaceted and works to the strong benefit of both sides.

We believe that the inclusion of Ireland as a “listed jurisdictions”, as provided for in Oregon law, could undermine the strong and mutually-beneficial business links which exist between Ireland and Oregon.

Given that Ireland does not meet the criteria under Oregon law to be treated as a “listed jurisdiction” and Ireland’s compliance with all international tax standards and the mutually-beneficial nature of the economic relationship between our two countries, I would request that Ireland not be included in any list of “listed jurisdictions” that the Oregon Department of Revenue may submit to the Oregon Legislative Assembly.

I would be most grateful if you would ensure that the contents of this letter be given due consideration by the Oregon Department of Revenue.

Yours sincerely,



Anne Anderson  
Ambassador

## Response to Ireland

Ambassador Anderson, Ireland's ambassador to the United States, raised the following issues in her September 7, 2016 letter to the department:

- Ireland is compliant with international standards and frameworks involving exchange of tax information and participates in anti-tax-avoidance initiatives.
- Ireland does not impose a nominal rate of corporate income tax.
- Ireland has ended its stateless company law.

The department does not dispute that Ireland is in compliance with international standards and frameworks involving exchange of tax information and participates in anti-tax avoidance initiatives. However, Ireland does impose a nominal rate of corporate income tax on many Irish-incorporated companies. In her response to our findings, Ambassador Anderson points out that companies that are tax-resident in Ireland pay a tax rate of 12.5 percent. Clearly, a tax rate of 12.5 percent is not a nominal rate of tax.

In this matter, the ultimate issue is that not all Irish-incorporated companies are tax-resident in Ireland. An Irish-incorporated company that is managed and controlled from a third country does not pay Irish tax if it was incorporated prior to January 1, 2015. This Irish-incorporated company may pay little, if any, tax if it is managed and controlled from a listed jurisdiction. Additionally, the company's net income is not included in the add-back required under ORS 317.716 because the company is not actually incorporated in the listed jurisdiction, just managed and controlled there. While this law is being phased out, that process won't be complete until 2021.

Therefore, the department does not change its recommendation for Ireland's inclusion as a listed jurisdiction under ORS 317.716(2)(b).



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**Comments to the  
Oregon Department of Revenue  
Concerning Additions to  
Tax Haven Blacklist**

**Nikki E. Dobay**  
Tax Counsel  
Council On State Taxation (COST)  
September 12, 2016

COST is submitting these comments to request the Department of Revenue (“Department”) reconsider its current recommendations to add seven jurisdictions to ORS § 317.716(1)(b) (“Tax Haven Blacklist”). As the Department is aware, COST is opposed to states designating foreign countries as “tax havens” for purposes of income tax base expansion. The State Tax Research Institute (“STRI”), a foundation affiliated with COST, released a comprehensive study in 2016 on tax haven legislation that details why such legislation is bad tax policy (*see* attached “State Tax Haven Legislation: A Misguided Approach to a Global Issue”). Based on the findings in our study and for the reasons discussed below, COST urges the Department to abandon its current efforts to add jurisdictions to the Tax Haven Blacklist and instead recommend to the Legislature that it repeal Oregon’s tax haven provisions.

**About COST**

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of approximately 600 major corporations engaged in interstate and international business. COST’s objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

**Tax Haven Lists Are Arbitrary and Misleading**

The branding of specific nations as “tax havens,” thereby penalizing companies merely incorporated there, is a counterproductive tax policy. “Blacklisting” specific countries is overly broad, and it may result in double taxation of legitimate business activities.

As the Department is aware, Oregon’s “tax haven” list is derived largely from a list created over 15 years ago by the Organization for Economic Co-operation and Development (“OECD”) to encourage countries to adopt greater transparency and

information sharing about tax issues, not to broaden the tax base of member countries. As of today, no countries remain on the OECD's list of uncooperative tax jurisdictions. Moreover, neither the United States nor the OECD in its "base erosion/profit shifting," or "BEPS," project has adopted the "tax haven" list approach. Neither state legislatures nor state revenue departments are equipped to make determinations the U.S. Government declined to exercise.

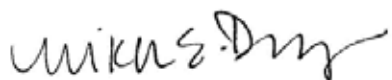
### **The Slippery Slope to Worldwide Unitary Combination**

Tax haven lists apply, on a selective country-by-country basis, the discredited "worldwide" combination method for the state taxation of multinational businesses. State attempts in the 1970s to tax the income of the worldwide unitary group, including entities with no U.S. presence, created considerable apprehension among both foreign governments and foreign and domestic multinational business enterprises, instigating what many thought would be an international tax war. Indeed, in 1985, the United Kingdom took the unprecedented approach of approving legislation that would have allowed the U.K. Treasury to penalize multinational companies with operations in any U.S. state employing worldwide combination. A Presidential Working Group agreed to forestall federal intervention if states limited unitary combination to a domestic water's-edge approach.<sup>1</sup> The Department's maintenance of Oregon's blacklist undermines the 30-year consensus among the states to limit their income tax base to the "water's-edge" and avoid the taxation of income earned outside the United States. The tax haven list approach interferes with U.S. foreign relations, threatening our nation's ability to "speak with one voice" in its dealings with our key trading partners and will likely be subject to judicial challenge in the coming years.

For the reasons discussed above and those cited in the STRI study, COST urges the Department to abandon its current efforts and instead recommend that the Legislature repeal Oregon's tax haven provisions.

Please contact me if you have any questions.

Sincerely,



Nikki E. Dobay

cc: COST Board of Directors  
Douglas L. Lindholm, COST President & Executive Director

# State Tax Haven Legislation: A Misguided Approach to a Global Issue

KARL FRIEDEN AND FERDINAND HOGROIAN

FEBRUARY 2016

## **ABOUT STRI**

The State Tax Research Institute (STRI) is a 501(c)(3) organization established in 2014 to provide educational programs and conduct research designed to enhance public dialogue relating to state and local tax policy. STRI is affiliated with the Council On State Taxation (COST). For more information on STRI, please contact Douglas L. Lindholm at [dlindholm@cost.org](mailto:dlindholm@cost.org).

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## **ACKNOWLEDGEMENTS**

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# EXECUTIVE SUMMARY <sup>1</sup>

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**This approach...**  
raises significant political, economic development, and constitutional concerns for states.

**T**ax haven legislation has recently emerged as a significant trend among states for addressing the taxation of foreign source income. There remains, however, a large gap between states that have introduced such legislation and those that have adopted such legislation. While twelve new states considered tax haven legislation in 2015, only one (Connecticut) adopted such legislation. The overall number of states that have enacted tax haven legislation remains relatively small: two states with blacklists of deemed tax haven nations (Montana and Oregon), four jurisdictions with a subjective list of tax haven criteria (Connecticut, Rhode Island, West Virginia, and the District of Columbia), and one state with a unique tax rate/intercompany transactions test (Alaska). Even this small number of state adoptions vary widely, including significant limitations on tax haven inclusion in Connecticut and Rhode Island.

At its core, state tax haven legislation seeks to expand the scope of state taxation to encompass income earned by foreign subsidiaries in countries that a state defines as tax haven jurisdictions. This approach signals at least a partial return to the mandatory worldwide combination filing method abandoned by the states in the 1980s, and raises significant political, economic development, and constitutional concerns for states.

This report analyzes state tax haven legislation and makes the following findings: 1) there is no clear evidence that profit shifting to tax havens is eroding the state corporate tax base; 2) state tax haven blacklists are arbitrary and unmanageable; and 3) states adopting tax haven legislation risk losing investments and jobs, and face constitutional challenges.

## **THERE IS NO CLEAR EVIDENCE THAT PROFIT SHIFTING TO TAX HAVENS IS ERODING THE STATE CORPORATE TAX BASE**

According to the analysis relied on by the proponents of state tax haven legislation, the period since 2000 has been the peak of corporate base erosion and profit shifting—with 85 percent of the alleged rise in annual tax revenue loss occurring during those years. Nonetheless, during that period, the overall share of state and local taxes paid by businesses has remained remarkably stable, generally within one percentage point of 45 percent of all state and local taxes paid each year. Indeed, the share of state and local taxes paid by businesses is actually higher in FY2014 (45 percent) than it was in FY2000 (42.6 percent), and above the average for the period since FY2000. The corporate income tax (and other business activity taxes) as a share of overall state and local taxes paid by business has also been relatively stable over the last 15 years, ebbing and flowing primarily with the cycles of the U.S. economy. Thus, based on the empirical evidence, the impact on the aggregate state and local tax base of any corporate profit shifting to foreign tax havens has been limited, and more than offset by increases in other taxes paid by business.

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<sup>1</sup> This Executive Summary summarizes the findings and supporting research contained in the body of the Report.



Similarly, the revenue loss estimates made by proponents of state tax haven legislation have been grossly inflated and are completely out of line with the states' own revenue estimates. For example, the District of Columbia estimated its proposed adoption of a tax haven list of nations would net the District \$3.7 million in FY 2017. By contrast, U.S. PIRG, a major proponent of tax haven legislation, put its original "tax haven" revenue estimate for D.C. at \$284 million and its revised revenue estimate at \$17.9 million. Likewise, New Hampshire estimated its tax haven proposal would net the state approximately \$5.1 million annually beginning in FY 2016, far less than U.S. PIRG's original revenue estimate of \$98 million or its revised revenue estimate of \$26.1 million.

### **STATE TAX HAVEN BLACKLISTS ARE ARBITRARY AND UNMANAGEABLE**

The recent experience of states that have enacted tax haven legislation confirms that state tax haven lists are inherently arbitrary and unmanageable. Initially, state blacklists were based on a list of countries designated as tax havens by the Organization for Economic Cooperation & Development (OECD). However, the OECD lists were maintained not for tax base expansion, but for purposes of effective information exchange and transparency. Once all of the countries on the list complied with OECD rules on information sharing and transparency, they were removed, resulting in the discontinuation of the OECD list.

The OECD and G20 nations recently completed a massive international tax reform project aimed at addressing base erosion and profit shifting (BEPS). Conspicuously absent from the several thousand pages of OECD reports was any support for singling out "bad actor" countries to be placed on a blacklist of so-called "tax haven" nations. Instead, the OECD solutions target outdated tax rules applied to particular transactions and structures that do not adequately reflect where the income is earned.

Without any U.S. or international guidance, the states have struggled to determine which countries, if any, should be listed as tax haven jurisdictions. The blacklist process is undermined because states (as subnational units) generally do not have expertise in, nor responsibility for, international tax rules, tax treaties, or foreign affairs. The difficulty of creating and managing state tax haven lists is reflected in the actions of the Multistate Tax Commission, West Virginia, Connecticut and the District of Columbia—all of which abandoned their tax haven lists in favor of a less sweeping "criteria" approach, often with significant restrictions on income inclusion.

### **STATES ADOPTING TAX HAVEN LEGISLATION RISK LOSING INVESTMENT AND JOBS AND FACE CONSTITUTIONAL CHALLENGES**

State tax haven legislation also carries significant risks for states, including reduced business employment and investment, potential foreign retaliation, and constitutional challenges. Similar to mandatory worldwide combination, which was abandoned by the states in the 1980s under pressure from the federal government and foreign nations, tax haven legislation taxes foreign source income beyond the "water's-edge" and makes no distinction between companies

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**...any state that adopts** tax haven legislation will be out of sync with both international approaches to taxing foreign source income and the tax policies of the vast majority of other states.

with domestic or foreign parents. During the 1980s, foreign nations actually authorized retaliatory tax treatment against U.S. multinationals in response to worldwide combined reporting. Foreign countries likewise have repeatedly and strenuously objected to inclusion in state tax haven lists. The resulting uncertainty and disincentive to invest in states considering and adopting such legislation could have profoundly negative impacts on state economic growth. For example, in 2013 alone, foreign direct investment in the 50 states totaled \$236.3 billion. The risk is magnified because any state that adopts tax haven legislation will be out of sync with both international approaches to taxing foreign source income and the tax policies of the vast majority of other states (including the largest 25 states as measured by population).

In addition, state tax haven legislation will almost certainly face legal challenges under the Foreign Commerce Clause and Foreign Affairs Powers Doctrine. With the enactment of tax haven legislation, states are meddling in foreign affairs and international relations—areas the Constitution entrusts solely to the Federal Government. While state worldwide combined reporting regimes ultimately withstood constitutional scrutiny, the result may be different with state tax haven statutes that make selective determinations about the adequacy of foreign nations' laws and arbitrarily designate certain nations for punitive treatment.

## CONCLUSION

In conclusion, aggressive state policies toward taxing foreign source income—based on the premise there is a gaping hole in the state business tax base caused by profit shifting to foreign “tax haven” nations—are misguided. Over the last three decades, states have uniformly rejected worldwide combined reporting in favor of a water's-edge filing method that generally includes domestic corporations and excludes foreign corporations. To diverge from this consensus and enact state tax haven legislation reflects a fundamental misunderstanding of both the need for and efficacy of these policies.

# INTRODUCTION

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Over the last few years, taxing foreign subsidiary income has become a hot topic internationally, at the federal level, and at the state level in the United States. A number of converging economic and political factors have weakened international tax rules on cross border transactions, including expanding globalization, the rise in importance of intangibles and digital commerce, widespread tax competition between nations, and complex corporate supply chains and tax structures.

**A**t the international level, the Base Erosion and Profit Shifting (BEPS) project carried out by the Organization for Economic Cooperation and Development (OECD) garnered significant attention, culminating with the October 2015 release of over two thousand pages of analysis and fifteen “actions” agreed to by the G-20 nations. This project has focused on mismatches, gaps and potential abuses in international tax rules, creating a disconnect between where value is generated and where profits are reported, and a shifting of income to lower-tax countries. By its own estimation, the OECD BEPS project is recommending the most profound changes to international tax regimes in 100 years.

At the federal government level, pressure continues to build for significant tax reform to an outdated federal tax code. The combination of U.S. reliance on a worldwide system of taxation (compared to a territorial system of taxation used by most other industrialized nations) and one of the highest corporate tax rates in the world undercuts the tax competitiveness of the U.S. compared to the other G-20 and OECD nations. The competitive tax disadvantage has created an incentive for U.S. multinationals to hold foreign earnings overseas (over \$2 trillion to date). These foreign earnings are not reinvested in a company’s domestic operations because of the high tax cost of bringing those profits home.

At the state level, the debate over foreign source income has recently focused on two policy initiatives—strengthening transfer pricing provisions and adopting state tax haven legislation. Many states have I.R.C. Section 482-like authority to impose arm’s-length standards on related party transactions, but the historic application of this transfer pricing authority has been limited.<sup>2</sup> Some states have been more aggressive in developing

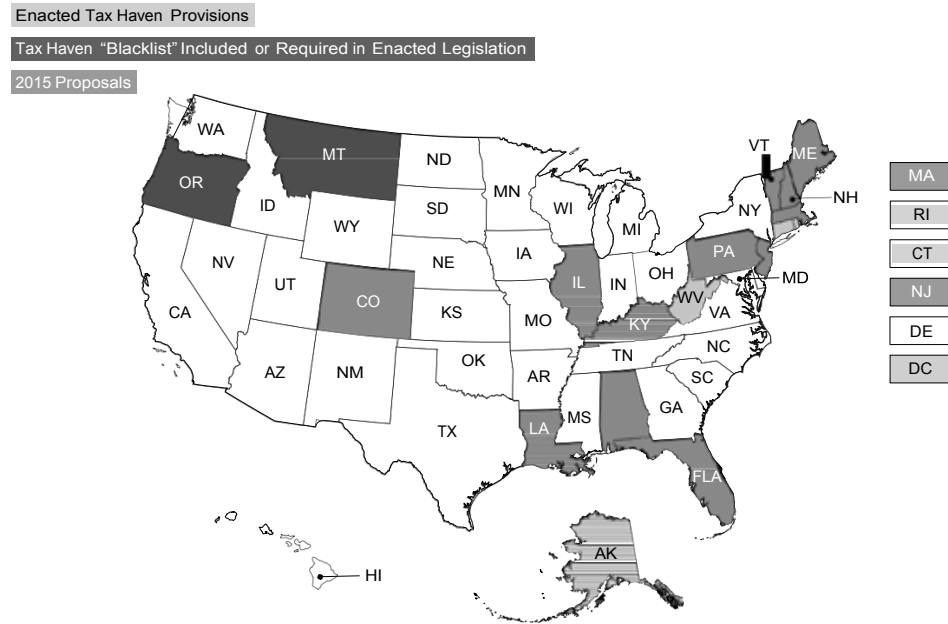
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<sup>2</sup> According to the Multistate Tax Commission (MTC), the reason for this is “[t]he states are currently ill equipped...to differentiate proper and improper income shifting and to address instances of improper income shifting.” Multistate Tax Commission, Design of an MTC Arm’s-Length Adjustment Service, May 7, 2015, at 2, available at <http://www.mtc.gov/getattachment/The-Commission/Committees/ALAS/Draft-of-Final-Design-Design-for-ALAS.PDF.aspx>.

## Tax haven legislation

generally comes in two variations: (1) states statutorily adopting a blacklist of designated countries... or (2) states adopting a list of “criteria” giving state tax agencies the discretion in audits to determine which nations may be considered tax havens...

FIGURE 1. TAX HAVEN LEGISLATION IN STATES



transfer pricing cases, but challenges to these audit adjustments proliferate.<sup>3</sup> Recently, the Multistate Tax Commission (MTC) spearheaded an effort to expand transfer pricing capabilities at the state level through its Arm's-Length Adjustment Service (ALAS) initiative. The final ALAS design, approved by the MTC's Executive Committee on May 7, 2015, proposes a four-year charter period for developing a multistate transfer pricing program with shared state resources.<sup>4</sup> In December 2015, the MTC, unable to sign up a sufficient number of charter state members to launch the program, assigned the project to a committee of six interested states for further development.<sup>5</sup>

A more significant trend relating to the state taxation of foreign source income has been the adoption or consideration of “tax haven” legislation. For the first time since the 1980s, when states pulled back from mandatory worldwide combination, many states are showing serious interest in expanding unitary taxation beyond the U.S. border (known as “water’s edge”). In this selective version of worldwide combined reporting, income inclusion only extends to foreign affiliates either incorporated in or doing business in “tax haven” nations. Tax haven legislation generally comes in two variations: (1) states statutorily adopting a blacklist of designated countries and including the income of foreign affiliated corporations located in those countries in the combined

<sup>3</sup> See, e.g., McDermott, Will, & Emery, *Beleaguered D.C. Taxpayers Achieve Another Success in Ongoing Challenges to the Methodology Used in the District's Transfer Pricing Audit Program*, Inside SALT, Nov. 20, 2014.

<sup>4</sup> See MTC, *ALAS Design*, supra note 2, at 1-2.

<sup>5</sup> Legal Alert: *Bueller? Bueller? MTC Still Calling on States to Join ALAS Program*, Sutherland Legal Alerts, Dec. 11, 2015, available at <http://www.sutherland.com/NewsCommentary/Legal-Alerts/181129/Legal-Alert-Bueller-Bueller-MTC-Still-Calling-on-States-to-Join-ALAS-Program>. See also Sutherland SALT, *Not So Fast: ALAS Fails to Attain Sufficient State Support*, Sutherland SALT Shaker, July 30, 2015, available at <http://www.stateandlocaltax.com/policy-and-legislation/not-so-fast-alas-fails-to-attain-sufficient-state-support/>.

income calculation; or (2) states adopting a list of “criteria” giving state tax agencies the discretion in audits to determine which nations may be considered tax havens, thereby including income from foreign subsidiaries operating in such nations in the tax base.

Of the states that have adopted “tax haven” statutes and regulations, only Montana and Oregon currently maintain a blacklist of specified tax haven jurisdictions. The Multistate Tax Commission, West Virginia, the District of Columbia, and Connecticut all initially favored a tax haven blacklist, but then subsequently abandoned this approach in favor of the “criteria” approach. The criteria-based approach—leaving designation of tax haven countries to the discretion of a state’s tax agency—has been adopted by Alaska (a significantly different regime),<sup>6</sup> the Multistate Tax Commission, West Virginia, Rhode Island, the District of Columbia, and Connecticut.

Along with the seven states that have adopted state tax haven legislation, eleven additional states considered tax haven proposals in 2015 (see Figure 1). The clear trend among the states is toward the blacklist approach, with nine of the eleven states in 2015 including specific “lists of countries” in their proposed legislation (*i.e.*, Colorado; Kentucky; Illinois; Louisiana; Maine; Massachusetts; New Hampshire; Pennsylvania; and Vermont). While tax haven legislation has generally been confined to smaller states, new proposals in 2015 included four of the eleven largest states by gross state product (*i.e.*, Florida, Illinois, Massachusetts, and Pennsylvania). The rash of state tax haven legislative proposals has engendered considerable opposition by multinational companies, many foreign embassies and ambassadors, and business organizations.

Proponents of tax haven statutes contend such legislation is needed because of (in their words) the “manipulation” of international tax rules by U.S. and foreign incorporated multinational corporations to hide profits in “tax haven” countries; the enormous yearly state tax revenue losses attributable to profit shifting to foreign jurisdictions (*e.g.*, claims made of annual revenue losses exceeding \$20 billion); and the allegation that big business does not pay its fair share of state and local taxes. To cure these supposed ills, proponents support tax haven legislation that would sweep the income of foreign subsidiaries in certain blacklisted countries into the state tax base—regardless of any connection to domestic income-producing activities. In effect, this extends the unitary business concept used by combined reporting states to a portion of worldwide business activities.

This report analyzes state tax haven legislation in the context of the global focus on BEPS and concludes such legislation is a misguided approach doing more harm than good. In particular, the report focuses on the arbitrary criteria used in identifying and monitoring so-called “tax haven” countries; the exaggerated state tax revenue loss estimates; the lack of any clear evidence the business share of state and local taxes has declined over the last fifteen years (allegedly the peak period of revenue loss attributable to corporate base erosion and profit shifting); and the significant downside of a go-it-alone state tax approach that is out of sync with the OECD approach to BEPS.

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**The rash of state tax haven legislative proposals has engendered considerable opposition by multinational companies, many foreign embassies and ambassadors, and business organizations.**

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<sup>6</sup> See Alaska Stat. § 43.20.145. The concept of listing nations or of applying tax haven criteria to determine whether a nation is a tax haven is not present in the Alaska regime.

## STATE TAX HAVEN LISTS ARE ARBITRARY AND UNMANAGEABLE

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State tax haven legislation is based on the premise that certain nations have tax rules so favorable to business and so conducive to manipulation they should be singled out by states for special punitive measures. However, the difficult question implicated by this legislation is how to objectively identify “bad actor” nations given the many different elements of a country’s tax system that might be considered, including tax rates, tax bases, exemptions, taxpayer classifications, related party rules, jurisdictional issues, treaties, and special incentive measures.

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**Is it appropriate for...** (U.S. states) to act unilaterally in the absence of any U.S. or international standard or agreement regarding which countries should be penalized?

**W**hich factors should be considered more important by a state for inclusion of a country on a tax haven list? Is a low tax rate the most important criteria? Overly generous corporate incentive programs? A mismatch of rules with other countries? The absence of a tax treaty with the United States? A lack of transparency? Some combination of all of the above? If taken in combination, are the factors weighted by the degree of a nation’s infraction?

The OECD BEPS report illustrates the importance of carefully defining what the nature of the tax policy problem is, before adopting solutions to the problem.<sup>7</sup> The OECD report acknowledges that each sovereign country has the right to determine its own statutory rates and general incentives provided to business taxpayers. The existence of these corporate income tax features reflects sovereign decisions about business tax competitiveness, not evidence that countries are “bad actors” in terms of encouraging base erosion and profit shifting. The OECD report emphasizes that real economic investments made in response to lower tax rates and general incentives are not BEPS. It is the artificial shifting of income—unrelated to real economic activity—that is the problem. State tax haven legislation ignores this distinction, claiming certainty where there is ambiguity and objectivity where there is subjectivity.

Moreover, state tax haven legislation raises several other threshold policy questions. Is it appropriate for subnational governments (such as the U.S. states) to act unilaterally in the absence of any U.S. or international standard or agreement regarding which countries should be penalized? Once included, how does a state determine if a country has changed its tax policies sufficiently to come off the list? The blacklist process is

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<sup>7</sup> OECD 2015, OECD/G20 Base Erosion and Profit Shifting Project (OECD), 2015 Final Reports, available at <http://www.oecd.org/ctp/beps-2015-final-reports.htm>.

undermined because states (as subnational units) generally do not have expertise in, nor responsibility for, international tax rules, tax treaties, transfer pricing, or foreign affairs.

A close historical review of state adoption or consideration of tax haven legislation demonstrates how arbitrary and unmanageable it is for states to create and maintain their own blacklist or set of criteria for “tax haven” country designation.

## **MONTANA’S BLACKLIST APPROACH IS BASED ON AN OUTDATED OECD LIST**

In 2003, Montana became the first state to create a blacklist of specific “tax haven” nations by statute. Prior to that time, in the 1990s, Utah and Alaska had enacted more limited tax haven-type legislation that focused on the issue of low tax-rate foreign jurisdictions without creating a specific list of tax haven countries.<sup>8</sup> The Montana legislation required inclusion under a water’s-edge election of the income and apportionment factors of unitary affiliates incorporated in specified “tax haven” jurisdictions.<sup>9</sup> This “listing” approach proved a stark departure from the more limited approaches in Alaska and Utah. The Montana statute did not focus on effective tax rates or significant economic activity. Instead, it simply required the automatic inclusion of income and apportionment factors of unitary affiliates incorporated in a list of 38 foreign jurisdictions.

The Montana list was based on the list of “uncooperative tax havens” published a year earlier by the OECD in April 2002.<sup>10</sup> No state previously had sought to create a blacklist, so it is not surprising Montana would turn to a reputable international organization for guidance. However, the 2002 OECD list of 35 countries was developed and maintained for an entirely different purpose.<sup>11</sup> When it announced its 2002 list, the OECD did not seek to establish a punitive international tax regime with respect to the listed nations for purposes of expanding the tax base of other countries.

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<sup>8</sup> Utah in 1993 included within its statutory water’s-edge provision “tax haven corporations”. The definition of “tax haven corporation” referenced the corporation’s effective rate in the foreign jurisdiction when compared to the U.S. top marginal rate, and further looked to whether the corporation had “substantial business activity independent of that involving [unitary] affiliates”. Utah Code Ann. § 59-7-101(32) (adopted by 1993 Utah Laws ch. 169, § 4). This provision was repealed in the following year. 1994 Utah Laws ch. 178, § 2. The former Utah provisions were similar to legislation adopted two years earlier by Alaska in 1991, which remains in Alaska’s statutes. Alaska Stat. § 43.20.073, adopted by 1991 Alaska Laws ch. 11, § 3, renumbered as Alaska Stat. § 43.20.145. However, the Alaskan statute never used—nor today uses—the term “tax haven”. Rather, the statute looks to whether a corporation is incorporated in, or doing business in, a low or no tax foreign jurisdiction, to certain other standards related to the level of intercompany transactions, and to whether the corporation conducts significant economic activity. It is only in such specific circumstances, and only by regulation, that Alaska references such corporations as “tax haven corporations.” In neither Alaska’s current statute, nor Utah’s prior statute, did the state seek to designate a specific list of foreign jurisdictions as tax havens.

<sup>9</sup> Mont. Code Ann. § 15-31-322, as amended by 2003 Mont. Laws c. 521. See Appendix for a complete list of current tax haven nation designations by states.

<sup>10</sup> According to the Montana Department of Revenue, “The list of tax havens in 15-31-322, MCA, was developed primarily, but not exclusively, from the Organization for Economic Co-operation and Development (OECD).” Brenda Gilmer, Memorandum from Brenda J. Gilmer, Senior Tax Counsel to Dan R. Bucks, Director of Revenue, Nov. 17, 2010, at 2, available at <http://leg.mt.gov/bills/2011/Minutes/House/Exhibits/tah78a04.pdf>. Montana also makes tax haven designation decisions based on the Multistate Tax Commission’s criteria (in turn also based on the prior OECD criteria – see the Appendix for a list of the MTC criteria).

<sup>11</sup> References to the OECD list are to the OECD blacklist, as opposed to the OECD “white list” of countries implementing agreed-upon standards and “gray list” of countries committed to such standards. See Jane G. Gravelle, Cong. Research Serv., Tax Havens: International Tax Avoidance and Evasion (2015), available at <https://www.fas.org/sgp/crs/misc/R40623.pdf>.

Rather, it “look[ed] forward to working with all the jurisdictions [on the list] towards the twin goals of transparency and effective information exchange.”<sup>12</sup>

The different purposes of the OECD list and the Montana list are reflected in the fact that seven of the jurisdictions included for punitive treatment by Montana in 2003 were cited by the OECD in its April 2002 release as working with the OECD to develop models for exchange of information.<sup>13</sup> By 2009, the OECD found every nation on its tax haven list had made commitments to transparency and effective exchange of information sufficient to meet OECD standards.<sup>14</sup> “As a result,” the OECD notes, “no jurisdiction is currently listed as an unco-operative tax haven by the [OECD] Committee on Fiscal Affairs.”<sup>15</sup> Subsequently, no other international organization has actively maintained and monitored a similar standardized list—leaving Montana and other states adrift to implement tax haven blacklists on their own.

While the OECD continuously reviewed its list and worked with jurisdictions to ultimately remove all of them from it, the Montana Legislature has maintained a largely static list. Despite a requirement in the statute calling for the Montana Department of Revenue to conduct a biannual review of the countries on the list, Montana’s sole update to its 13-year-old list occurred in 2009, when its legislature added Cyprus, Malta, Mauritius, and San Marino, and removed Maldives and Tonga from its list.<sup>16</sup> The update was “[b]ased upon Department of Revenue research on the issue,” and was scored as having no overall revenue impact to the State.<sup>17</sup> In November 2010, the Montana Department of Revenue acknowledged its quandary: it noted that while prior list update proposals were based in large part on the OECD blacklist, “The current focus of the OECD is promoting transparency and the exchange of tax information for tax purposes...[and] the OECD is not actively updating its list of tax havens[.]”<sup>18</sup>

More recently, in 2014, the Montana Department of Revenue recommended removing the Netherlands Antilles and Monaco from the list, and adding the Kingdom of

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<sup>12</sup> See Gabriel Makhoulf, *The OECD List of Unco-operative Tax Havens—A Statement by the Chair of the OECD’s Committee on Fiscal Affairs*, available at <http://www.oecd.org/corruption/theoecdlistofunco-operativetaxhavens-astatementbythechairoftheoecdscmmitteeonfiscalaffairsgabrielmakhoulf.htm>. When the OECD launched its initiative in 1998, it had a somewhat broader focus that included “to address harmful tax practices—in member and non-member jurisdictions.” *Id.* However, in 2001–2002, this focus was narrowed to the goals of transparency and effective information exchange. *Id.* For the original 1998 OECD criteria, see OECD, *Harmful Tax Competition: An Emerging Global Issue* (1998), available at <http://www.oecd.org/tax/transparency/44430243.pdf>.

<sup>13</sup> See OECD, *List*, supra n. 12.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* Over the last ten years, several other tax haven lists have been formulated largely from the (since discarded) OECD list, but consideration of additional factors have produced significant variations. For example, the Tax Justice Network, for its list, started with all jurisdictions on the OECD list and then conducted a “reputation test” by reviewing tax planning websites and documentation of tax legislation in the jurisdiction. See Tax Justice Network, *Briefing Paper, Identifying Tax Havens and Offshore Finance Centers*, available at [http://www.taxjustice.net/cms/upload/pdf/Identifying\\_Tax\\_Havens\\_Jul\\_07.pdf](http://www.taxjustice.net/cms/upload/pdf/Identifying_Tax_Havens_Jul_07.pdf). The National Bureau of Economic Research (NBER) based its list on the coexistence of low business tax rates and identification of the jurisdiction as a tax haven by “multiple authoritative sources”. See Dhammika Dharmapala & James R. Hines, Jr., *Which Countries Become Tax Havens?*, NBER Working Paper No. 12802, 2006, available at <http://www.nber.org/papers/w12802.pdf>.

<sup>16</sup> Governor’s Office of Budget and Program Planning, *Fiscal Note 2011 Biennium* (S.B. 0043), available at <http://leg.mt.gov/bills/2009/FNPDF/SB0043.pdf>.

<sup>17</sup> *Id.*

<sup>18</sup> Brenda Gilmer, supra n. 10, at 5.



the Netherlands, Trinidad and Tobago, Guatemala, and Hong Kong.<sup>19</sup> In arriving at these recommendations, the Department relied on a hodgepodge of third-party information, for the most part, not intended to be the basis for compiling a tax haven blacklist. This information included tax summaries-by-country reports from Deloitte and KPMG, current OECD information, and U.S. PIRG publications.<sup>20</sup> The Montana Department of Revenue provided scant details on how it applied these information sources in arriving at its recommendations. Ultimately, Ireland and Switzerland also appeared on the list of tax haven amendments proposed in the Montana legislature in 2015.<sup>21</sup> While the bill passed out of a Senate committee by a 7–5 vote, it was re-referred, tabled in committee and ultimately not enacted.

## THE MULTISTATE TAX COMMISSION DISCARDS THE BLACKLIST

Following Montana's 2003 enactment of a tax haven blacklist, the Multistate Tax Commission (MTC) took a similar approach in 2006.<sup>22</sup> In that year, the MTC adopted its Model Combined Reporting Statute that included within the water's-edge tax base the income of members doing business in a tax haven country. The Statute defined "tax haven" as a "jurisdiction that, during the tax year in question...is identified by the Organization for Economic Co-operation and Development (OECD) as a tax haven[.]"<sup>23</sup> At the same time, the MTC adopted a "criteria" list, adding to the tax base any income of companies doing business in a country that met the "criteria".<sup>24</sup> However, three years later in 2009, the MTC recognized the problem of linking to an OECD tax haven list that was largely abandoned by the OECD itself. The Executive Committee of the MTC instructed its Uniformity Committee to consider whether changes should be made to the definition of "tax haven" in the MTC's Model Combined Reporting Statute. In 2011, the MTC approved an amendment that deleted the OECD list approach and kept only the "criteria" approach (while striking references to the OECD from its model statute).<sup>25</sup> Since then, the MTC has refrained from adopting a blacklist of tax haven countries that Montana or any other state could rely on as a basis for their own lists.

The MTC hearing officer's report on the amendment to the Model Statute made clear the rationale for the shift away from the blacklist approach:

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<sup>19</sup> See Mike Kadas, Memorandum from Mike Kadas, Director, to the Revenue and Transportation Interim Committee, July 16, 2014, at 1, available at [https://revenue.mt.gov/Portals/9/committees/Revenue\\_Transportation/2013-2014/July/Tax%20Haven%20Report%20Country%20Update%20July%2016%202014.pdf](https://revenue.mt.gov/Portals/9/committees/Revenue_Transportation/2013-2014/July/Tax%20Haven%20Report%20Country%20Update%20July%2016%202014.pdf). The Netherland Antilles has not been a country since 2010.

<sup>20</sup> Id.

<sup>21</sup> See S.B. 167, 64th Leg., Reg. Sess. (Mont. 2015), available at [http://leg.mt.gov/bills/2015/sb0199/SB0167\\_1.pdf](http://leg.mt.gov/bills/2015/sb0199/SB0167_1.pdf).

<sup>22</sup> See Multistate Tax Commission, Proposed Model Statute for Combined Reporting, available at [http://www.mtc.gov/uploadedFiles/Multistate\\_Tax\\_Commission/Uniformity/Uniformity\\_Projects/A\\_-\\_Z/Combined%20Reporting%20-%20FINAL%20version.pdf](http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/Combined%20Reporting%20-%20FINAL%20version.pdf).

<sup>23</sup> Multistate Tax Commission, Report of the Hearing Officer, Proposed Amendment to MTC Model Statute for Combined Reporting—Inclusion of Companies Doing Business in "Tax Havens" Under Water's Edge Election, May 27, 2011, at 2–3, available at [http://www.mtc.gov/uploadedFiles/Multistate\\_Tax\\_Commission/Uniformity/Uniformity\\_Committee\\_and\\_Subcommittees/June\\_6,\\_2011\\_Executive\\_Committee\\_Meeting/taxhavenhearingofficerreportfinal.pdf](http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Committee_and_Subcommittees/June_6,_2011_Executive_Committee_Meeting/taxhavenhearingofficerreportfinal.pdf). Note that the water's edge was by "election"—instead of the default worldwide reporting.

<sup>24</sup> Id. at 3–4.

<sup>25</sup> Id.; See also Multistate Tax Commission, Resolution Adopting Amendment to Model Combined Reporting Statute; Definition of "Tax Haven" for Water's Edge Election, July 27, 2011, available at [http://www.mtc.gov/uploadedFiles/Multistate\\_Tax\\_Commission/Committees/Executive\\_Committee/Scheduled\\_Events/44th\\_Annual\\_Meetings/taxhavenfinal1.pdf](http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Committees/Executive_Committee/Scheduled_Events/44th_Annual_Meetings/taxhavenfinal1.pdf).

“in response to concerns expressed by the United States and others, as early as 2001 the OECD was beginning to move away from the task of classifying jurisdictions as ‘tax havens’ or as having ‘harmful preferential tax regimes’ in favor of a new classification system based on a jurisdiction’s commitment to and progress in improving financial transparency laws and in protecting taxpayer confidentiality... Although the OECD has not entirely abandoned its ‘tax haven’ classification, the phrase now only appears with reference to jurisdictions which were originally listed as tax havens in the OECD’s 2000 report and which have not achieved compliance with [Internationally Agreed Tax Standards for financial transparency]... It should be beyond dispute that the model combined reporting statute’s reference to an organization’s ‘historical’ lists is untenable, especially where the organization has developed new classifications based on a new set of criteria.”<sup>26</sup>

### THE EXPERIENCE WITH “TAX HAVEN” BLACKLISTS IN OTHER STATES

Prior to the MTC’s disavowal of the blacklist approach, West Virginia in 2008 adopted unitary combined reporting based on the MTC model. As a result, it included the MTC’s reference to the OECD, which identified a tax haven as “a jurisdiction that, for a particular tax year in question... [i]s identified by the Organization for Economic Cooperation and Development as a tax haven or as having a harmful preferential tax regime[.]”<sup>27</sup> The statute also included reference to the MTC criteria.<sup>28</sup> However, in an amendment adopted in 2011, West Virginia significantly (but perhaps not clearly) limited its reference to the OECD list, providing retroactively that all amendments to the OECD list made between March 8, 2008 and January 1, 2011 “shall be given effect in determining whether a jurisdiction is a tax haven[.]”<sup>29</sup> Given the changes to the OECD list that took place during that time period, it is unclear what nations, if any, might still be included under West Virginia’s OECD reference.

Unlike West Virginia’s adoption of the (prior) MTC model, the next state that took the blacklist approach—Oregon—copied the Montana model of listing nations in its statute. Oregon’s experience in updating its tax haven list is instructive. Enacted in 2013, Oregon’s existing list admittedly “is modeled after Montana’s foreign tax haven list[.]”<sup>30</sup> In recommending updates to the list, the Oregon Department of Revenue stated it “used the 2011 MTC criteria in this report to identify recommended additions to or subtractions from the list[.]”<sup>31</sup> However, the Department did not describe how it identified which nations to subject to its inquiry. For example, Ireland (a nation included in Montana’s 2015 legislative proposal) is not mentioned in the report.

The updated Oregon analysis appears to be based on the same subjective information gathering exercise used by Montana. For example, with respect to the Netherlands, the

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<sup>26</sup> MTC, Report of the Hearing Officer, *supra* note 23, at 4–5.

<sup>27</sup> See 2008 W.Va. Acts, ch. 215, eff. June 7, 2008, available at [http://www.legis.state.wv.us/Bill\\_Text\\_HTML/2008\\_SESSIONS/RS/Bills/sb680%20intr.htm](http://www.legis.state.wv.us/Bill_Text_HTML/2008_SESSIONS/RS/Bills/sb680%20intr.htm).

<sup>28</sup> *Id.*

<sup>29</sup> See 2011 W. Va. Acts ch. 173, eff. March 10, 2011, available at <https://legiscan.com/WV/text/SB371/id/244568>.

<sup>30</sup> See Oregon Department of Revenue, Recommendations on Tax Haven Jurisdictions, 6 (Jan. 1, 2015), available at <http://library.state.or.us/repository/2015/201502051256044/>.

<sup>31</sup> *Id.* at 8.

report finds “it is feasible to use hybrid financing arrangements to lower a Dutch tax bill. A recent Dutch Supreme Court decision makes clear that a financial instrument will be classified as debt or equity based on Dutch law without regard to how the financial instrument may be classified in a different country. One commentator noted this raises the possibility for profit shifting into the Netherlands.”<sup>32</sup> The report also notes “a number of tax incentives and structures” available in the Netherlands, the percentage of profits of U.S. corporations in the Netherlands in relation to Dutch GDP, and “[m]ost notably, Netherlands law allows a company to set up using a post office box.”<sup>33</sup> The report further asserts, “wide publicity has been given to the role played by the Netherlands in tax avoidance schemes”, citing a New York Times article.<sup>34</sup> It is unclear the degree to which popular press and other third-party accounts influenced the Department’s judgment other than the MTC’s criteria.

**The D.C. experience** highlights states are ill equipped to judge the adequacy of individual nations’ tax structures against criteria which were developed in an entirely different context...

Legislation was proposed in Oregon in 2015 to extend the State’s tax haven list to Guatemala, Hong Kong, the Netherlands, and Trinidad and Tobago.<sup>35</sup> However, as enacted, S.B. 61 only expanded the tax haven list to Guatemala and Trinidad and Tobago.<sup>36</sup> Neither is on the Montana list.

The District of Columbia in 2015 became the next U.S. jurisdiction to statutorily adopt a tax haven list.<sup>37</sup> The list replicated the existing Montana list, but without Panama.<sup>38</sup> The District of Columbia’s list was adopted without any tax committee hearings or public explanation regarding how the tax haven list of nations was derived. However, facing intense criticism of the arbitrary nature of the list, the District’s City Council reversed course and postponed implementation of the list.<sup>39</sup> The D.C. experience highlights states are ill equipped to judge the adequacy of individual nations’ tax structures against criteria which were developed in an entirely different context (the OECD’s efforts to increase transparency and information exchange). As noted by a commentator in response to the D.C. Chairman’s proposal, “Even assuming a state has proper criteria, the criteria would need to be applied every six months if not more frequently to take into consideration the changing circumstances... When states without professionals experienced in tax and anti-money-laundering policy try to apply the OECD 1998 criteria [for designation of tax havens], they are bound to make many mistakes... The D.C. government and U.S. states do not have the resources to effectively conduct such evaluations and make such judgments.”<sup>40</sup>

Connecticut in 2015 experienced an outcome very similar to that in D.C. Connecticut adopted unitary combined reporting in 2015, with a delayed 2016 effective date.<sup>41</sup>

<sup>32</sup> Id. at 33.

<sup>33</sup> Id. at 33.

<sup>34</sup> Id. at 34, citing ‘Double Irish with a Dutch Sandwich’, N.Y. Times, Apr. 28, 2012, at A1.

<sup>35</sup> See H.B. 2099, 78th Leg., Reg. Sess. (Or. 2015).

<sup>36</sup> S.B. 6, 78th Leg., Reg. Sess. (Or. 2015).

<sup>37</sup> See 2015 D.C. Act A21-0148, available at <http://iims.dccouncil.us/Download/33645/B21-0158-SignedAct.pdf>.

<sup>38</sup> Id.

<sup>39</sup> See Maria Koklanaris, D.C. Council Chair to Introduce Legislation to Repeal Tax Havens List, 2015 STT 211-(Nov. 2, 2015) (“I got some letters, I got some phone calls, my staff got some phone calls, and they got some visits,” [Chairman] Mendelson said. ‘I felt we would be better served if we pulled back and took a closer look. I want to look more carefully at the countries. I don’t want us to make a mistake’ by adding a country that shouldn’t be there, he said.”)

<sup>40</sup> Id.

<sup>41</sup> 2015 Conn. Pub. Acts 15-244 (Reg. Sess.), available at <https://www.cga.ct.gov/2015/ACT/PA/2015PA-00244-R00HB-07061-PA.htm>.

Without...U.S. or international guidance...states... struggle to analyze international tax structures and national tax regimes to determine which countries should be listed as tax haven jurisdictions.

As part of its combined reporting adoption, it required the Department of Revenue Services to produce a tax haven list.<sup>42</sup> However, business reaction to the tax package (which included an extended corporate tax “surcharge,” limits on credit and net operating loss deduction utilization, and other tax increases) was extremely negative, with headquartered companies threatening to leave the State.<sup>43</sup> As a result, Connecticut passed amendatory provisions in a December 8, 2015 special session, including significant changes to the tax haven provisions. As part of these changes, the Department of Revenue Services is no longer required to produce a tax haven nation list, and a form of “whitelist” is included in the statute excluding certain treaty nations from the reach of the tax haven criteria analysis.<sup>44</sup>

Legislation proposed (but not enacted) in numerous additional states in 2015 generally copied the Montana blacklist approach, compounding the problem of developing a list of tax haven countries without any reasonable foundation in international tax law. Proposed legislation included bills filed in: Colorado (H.B. 1346, generally smaller/island economies); Maine (H.P. 235, including Ireland); Massachusetts (S.B. 1524/H.B. 2477, including Hong Kong, the Netherlands, Switzerland, and Singapore); and Pennsylvania (S.B. 117, including “tax havens” identified by the OECD for the taxable year, plus specifically Bermuda, the Cayman Islands, the Bailiwick of Jersey, and Luxembourg).

#### STATES, UNEQUIPPED TO UPDATE LISTS, LACK U.S. AND INTERNATIONAL GUIDANCE

As noted, the OECD abandoned its listing of uncooperative tax havens in 2009. The U.S. Government has not filled this gap, as it maintains no tax haven list for tax base expansion purposes. Finally, as noted above, the Multistate Tax Commission in 2011 abandoned its effort to maintain a blacklist of countries, recognizing its reliance on the OECD list was untenable. Without any U.S. or international guidance, the states with tax haven legislation struggle to analyze international tax structures and national tax regimes to determine which countries should be listed as tax haven jurisdictions.

More recently, in 2015, the European Union (EU) issued its first tax haven list. However, the EU list was not based on any criteria agreed to collectively by the EU countries, but rather reflected a consolidation of independent EU country lists.<sup>45</sup> These country lists themselves represent wildly differing approaches by the member EU countries.<sup>46</sup> Fifteen of the twenty-eight EU countries have no tax haven lists at all, including large member nations such as Germany and the United Kingdom.<sup>47</sup> Among the remaining thirteen EU countries, significant variations exist. For example, France

<sup>42</sup> See 2015 Conn. Pub. Acts 15-5 (Spec. Sess.), available at <https://www.cga.ct.gov/2015/ACT/PA/2015PA-00005-R00SB-01502SS1-PA.htm> (“the commissioner shall publish a list of jurisdictions that the commissioner determines to be tax havens. The list shall be applicable to income years commencing on or after January 1, [2016], and shall remain in effect until superseded by the publication of a revised list by the commissioner”).

<sup>43</sup> See Allysia Finley, *GE Escapes Connecticut*, Wall Street Journal, Jan. 13, 2016, available at <http://www.wsj.com/articles/ge-escapes-connectitax-1452730001>.

<sup>44</sup> See Conn. Pub. Acts 15-1 (Spec. Sess.), available at <https://www.cga.ct.gov/2015/ACT/pa/2015PA-00001-R00SB-01601SS2-PA.htm>.

<sup>45</sup> See European Commission Taxation and Customs Union, *Tax Good Governance in the World as Seen by EU Countries*, [http://ec.europa.eu/taxation\\_customs/taxation/gen\\_info/good\\_governance\\_matters/lists\\_of\\_countries/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/gen_info/good_governance_matters/lists_of_countries/index_en.htm).

<sup>46</sup> Id.

<sup>47</sup> Id.

has eight jurisdictions on its list; Italy has over 50 jurisdictions on its list; and Portugal has 80 countries on its list.<sup>48</sup> The subjective nature of the lists is highlighted by the absence of any EU countries on the EU lists—something that would not be permitted under EU rules.<sup>49</sup>

Not only are the separate EU country lists not standardized, but they are not transparent in terms of how the national lists are created and how the national criteria are translated into the EU listing effort.<sup>50</sup> Further, the EU nation lists are used for varying purposes—including transparency, information sharing, and in a small number of countries for the denial of deductions for dividends received from foreign affiliates on deferred income.

As a result, the EU country “tax haven” lists provide little guidance for states having or contemplating adoption of tax haven list statutes. While the EU continues to refine its approach to a consolidated EU tax haven list, it’s not clear what form the final list will take, to what purpose it will be used, or what credibility it will have given the highly politicized process.<sup>51</sup>

Any possibility the broader international community would create a standardized list of tax havens was eliminated by the 2015 release of the OECD BEPS project actions that steered completely clear of recommending any measures aimed at creating a blacklist of so-called “tax haven” nations and automatically including their income in the current year tax base of other countries (see discussion in Section 4).

In summary, the handful of states that have thus far adopted tax haven statutes have done so without relying on any internationally accepted list or international standards for identifying which countries should be included and maintained on the blacklists. Moreover, going forward, these states (and other ones that might choose to join them) are similarly handicapped.

Left to their own designs, the states—unlike most foreign nations—generally lack in-house knowledge or expertise in foreign affairs, international tax, transfer pricing rules, permanent establishment rules, or international treaties to assist them in evaluating which countries should be included on or removed from a blacklist. Importantly, only the federal

**Left to their own designs, the states...**  
generally lack in-house knowledge or expertise in foreign affairs, international tax, transfer pricing rules, permanent establishment rules, or international treaties to assist them in evaluating which countries should be included on or removed from a blacklist.

<sup>48</sup> Id.

<sup>49</sup> The EU lists have been sharply criticized. See Joe Kirwin EU Updates Tax Haven List But Criticism Lingers, 198 DTR 1-1 (Oct. 14, 2015); see also EU Hypocrites! The Naming and Shaming of Tax Havens is Fraught with Folly!, The Economist, Aug. 22, 2015, available at <http://www.economist.com/news/finance-and-economics/21661674-naming-and-shaming-tax-havens-fraught-folly-eu-hypocrites>. The EU lists continue to include countries deemed compliant by the OECD.

As noted previously, the OECD no longer maintains its list of “uncooperative tax havens.” However, the OECD in 2009 established the Global Forum on Transparency and Exchange of Information for Tax Purposes with a mandate to promote the rapid implementation of international standards of transparency and exchange of information. The project rates countries as “compliant,” “largely compliant,” “partially compliant,” and “non-compliant” with these standards. See OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, Tax Transparency 2015, Report on Progress, page 15, available at <http://www.oecd.org/tax/transparency/global-forum-annual-report-2015.pdf>.

<sup>50</sup> The European Commission website cites transparency, exchange of information, and fair tax competition as “standards of tax good governance,” but does not provide how these criteria are applied by the nations and how the criteria were applied to derive the EU list. See Press Release, European Commission, Tax Transparency: Commission Welcomes Agreement Reached by Member States on the Automatic Exchange of Information on Tax Rulings (Oct. 6, 2015), available at [http://europa.eu/rapid/press-release\\_IP-15-5780\\_en.htm](http://europa.eu/rapid/press-release_IP-15-5780_en.htm). This is probably because the criteria vary by nation, and, in fact, the EU provides that its list was merely a compilation of the most commonly listed nations among its members.

<sup>51</sup> On January 28, 2016, the European Commission (EC) presented its Anti-Tax Avoidance Package (ATAP). The package is now under consideration by the EU nations, 21 of 28 of which participated in the OECD BEPS project. European Commission proposes Anti-Tax Avoidance Package, PWC Tax Policy Bulletin, February 5, 2016, available at <http://image.edistribution.pwc.com/lib/fe9813707560007f73/m/1/european-commission-proposes-anti-tax-avoidance-package.pdf>.



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While the criteria approach may seem less offensive than the blacklist approach, it has its own set of problems that make it just as unworkable.

government has the ability to negotiate treaties with other nations. The absence of the relevant knowledge base is particularly troubling because the identification of which, if any, nations to place (and keep) on a blacklist requires not only an understanding of the rules of the so-called “tax haven” nation, but also of how other nations’ laws interact with the blacklisted nation to facilitate profit shifting. Not surprisingly, three jurisdictions (West Virginia, D.C., and Connecticut) and the MTC have backtracked and switched to the “criteria” approach after initially adopting the blacklist approach.

#### DIFFICULTIES WITH THE “CRITERIA” APPROACH

While the criteria approach may seem less offensive than the blacklist approach, it has its own set of problems that make it just as unworkable. Most of the states with the criteria approach follow the MTC model. Under the current MTC “criteria” model:

“Tax haven” means a jurisdiction that, during the tax year in question has no or nominal effective tax on the relevant income and:

- i. has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;
- ii. has a tax regime which lacks transparency. A tax regime lacks transparency if the details of legislative, legal or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers, or if the information needed by tax authorities to determine a taxpayer’s correct tax liability, such as accounting records and underlying documentation, is not adequately available;
- iii. facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;
- iv. explicitly or implicitly excludes the jurisdiction’s resident taxpayers from taking advantage of the tax regime’s benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction’s domestic market; or
- v. has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.<sup>52</sup>

In its water’s-edge provisions, the MTC model provides that “the entire income and apportionment factors of any [unitary group] member that is doing business in a tax haven” is included in the water’s-edge combined filing.<sup>53</sup> The model provides no guidance regarding how the criteria above are to be applied either by the taxpayer in determining its liability or the revenue agency in reviewing the taxpayer’s returns.

A small number of states (*e.g.*, D.C., Connecticut, Rhode Island and West Virginia) have adopted the “criteria” approach (generally based on the MTC criteria), leaving the

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<sup>52</sup> Multistate Tax Commission, Proposed Model Statute for Combined Reporting, available at [http://www.mtc.gov/uploadedFiles/Multistate\\_Tax\\_Commission/Uniformity/Uniformity\\_Projects/A\\_-\\_Z/Combined%20Reporting%20-%20FINAL%20version.pdf](http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/Combined%20Reporting%20-%20FINAL%20version.pdf).

<sup>53</sup> *Id.*

determination of tax haven jurisdictions to their state tax agencies.<sup>54</sup> None of these states has provided administrative guidance regarding how the criteria are to be applied either by the taxpayer or by its auditors. The only published application of the criteria has been, as previously noted, by blacklisting states in suggesting additions to their statutory lists.

Prior to the repeal of its list, the District of Columbia's tax code actually contained both the aforementioned blacklist and subjective criteria.<sup>55</sup> As a result, the Office of Tax and Revenue was authorized to determine a jurisdiction is a tax haven on audit even if it was not on the statutory list. This "worst of both worlds" scenario highlights the infirmities in both approaches. With the listing approach, taxpayers are bound to an inflexible standard for inclusion of foreign entities regardless of substance; with the criteria approach, taxpayers are subject to the capricious actions of revenue agencies in deeming which affiliates (likely profitable ones) are subject to a tax haven determination. The criteria approach takes the arbitrary tests for tax haven nations and pushes them from the legislature *a priori* to the revenue agency *a posteriori* to apply after the fact, on audit.

The infirmities in the criteria approach can also be seen in the numerous, and varying, carve-outs legislatures have crafted to try to avoid overreaching. In the case of the MTC (and as adopted by D.C.), an exception exists where "the member's business activity within a tax haven is entirely outside the scope of the laws, provisions and practices that cause the jurisdiction to meet the criteria[.]"<sup>56</sup> Rhode Island included within its tax haven provisions a carve-out for transactions at arm's length and not with the principal purpose of tax avoidance, and also a safety valve where the taxpayer shows the tax haven imposition to be unreasonable.<sup>57</sup> Connecticut took the unprecedented step of seeking to insulate specific nations from the criteria application: any country with a "comprehensive income tax treaty" with the U.S. that meets certain I.R.C. standards is essentially whitelisted.<sup>58</sup> Connecticut's recent action highlights the concern that application of the criteria would otherwise produce an arbitrary and unreasonable result not contemplated by the legislature.

As difficult as it is for state legislatures to make "tax haven" blacklist determinations, it is even more problematic for state tax agencies' audit staff to make fair and informed determinations. Instead, the auditors judge nations against very broad and ambiguous criteria (*e.g.*, "has laws or practices that prevent effective exchange of information... has [a] tax regime which lacks transparency...has created a tax regime which is favorable for tax avoidance").<sup>59</sup> State tax agencies have no objective framework for distinguishing between nations that encourage real economic activity with lower tax rates and incentives and those that sponsor artificial income shifting. The lack of guidance provided by state tax agencies using the "criteria" approach increases the compliance problems for businesses that need to determine which foreign entities, if any, should be included in the water's-edge tax base in those states. This uncertainty also creates problems for companies for financial accounting and reporting purposes.

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**State tax agencies** have no objective framework for distinguishing between nations that encourage real economic activity with lower tax rates and incentives and those that sponsor artificial income shifting.

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<sup>54</sup> Alaska has its own unique "criteria"-like statute. See *supra* note 8.

<sup>55</sup> See D.C. Act A21-0148, *supra* note 37.

<sup>56</sup> See MTC, Report of the Hearing Officer, *supra* note 23, at 2.

<sup>57</sup> See H.B. 7133, Reg. Sess. (R.I. 2014).

<sup>58</sup> Conn. Pub. Acts 15-1, *supra* note 44.

<sup>59</sup> See MTC criteria in Appendix.



## THE STATE TAX REVENUE LOSS ESTIMATES RELATING TO TAX HAVENS ARE HIGHLY EXAGGERATED

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One of the key underpinnings of the “tax haven” debate at the state level has been the supersized estimates of state tax revenue losses attributable to alleged “profit shifting” to “offshore tax havens”.<sup>60</sup> The estimated state revenue losses from tax havens derive from widely publicized studies by the advocacy group U.S. Public Interest Research Group (U.S. PIRG). In a January 2013 study, U.S. PIRG estimated the use of offshore tax havens by U.S. multinational corporations was responsible for \$26 billion in lost state corporate tax revenues in 2011.<sup>61</sup> A year later, U.S. PIRG claimed the use of offshore tax havens by U.S. multinational corporations resulted in the states losing approximately \$20.7 billion a year in corporate income tax revenue.<sup>62</sup>

**T**he \$20 billion plus state revenue loss estimate appears frequently both in media reports on tax haven legislation and in testimony presented at state legislative hearings.<sup>63</sup> The number was also prominently cited as a justification

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<sup>60</sup> The language used by proponents of “tax haven” legislation is consistently couched in tones of outrage and allegations of manipulation of tax reporting rules. Among the descriptions used are “tax shell games”, “offshore shell games”, and “offshore tax dodging”. See Benjamin Davis et al., *Tax Shell Game: How Much Did Offshore Tax Havens Cost You in 2010?*, U.S. PIRG Education Fund, Apr. 2011; Robert S. McIntyre et al., *Offshore Shell Games 2015: The Use of Offshore Tax Havens by Fortune 500 Companies*, U.S. PIRG Education Fund and Citizens for Tax Justice, Oct. 2015; U.S. PIRG News Release, Dan Smith, *Camp Corporate Tax Proposal Would Make Offshore Tax Dodging Easy For Large Multinationals*, Feb. 26, 2014, available at <http://www.uspirg.org/news/usp/camp-corporate-tax-proposal-would-make-offshore-tax-dodging-easy-large-multinationals>.

<sup>61</sup> Jordan Schneider et al., *The Hidden Cost of Offshore Tax Havens: State Budgets Under Pressure from Tax Loophole Abuse*, U.S. PIRG Education Fund, January 2013, at 10, available at [http://www.uspirg.org/sites/pirg/files/reports/USPIRG\\_State\\_Tax\\_Havens\\_0.pdf](http://www.uspirg.org/sites/pirg/files/reports/USPIRG_State_Tax_Havens_0.pdf). The U.S. PIRG study also estimates additional state tax revenue losses attributed to use of offshore tax havens by wealthy individuals at about \$14 billion. *Id.*

<sup>62</sup> Phineas Baxadnall et al., *Closing the Billion Dollar Loophole: How States Are Reclaiming Revenue Lost to Offshore Tax Havens*, U.S. PIRG, 2014, at 7, available at <http://www.uspirg.org/sites/pirg/files/reports/Closing%20the%20Billion%20Dollar%20Loophole%20Web%20vUS%20041414.pdf>. The U.S. PIRG did not provide an explanation for the discrepancy between the estimates in the 2013 and 2014 studies—both of which focused on 2011.

<sup>63</sup> Elaine S. Povich, *Hunting Lost Revenue in Offshore Tax Havens*, *The Pew Charitable Trusts: Research & Analysis: Stateline*, March 10, 2014; Jaimie Woo and Dan Smith, *Picking Up the Tab 2015: Small Businesses Pay the Price for Offshore Tax Havens*, U.S. PIRG Education Fund, April 2015, at 1; Mark Niquette, *States Target Corporate Cash Stashed Overseas*, *Bloomberg Business*, April 17, 2014.

for the MTC's Arm's-Length Adjustment Service (ALAS) project in May, 2015.<sup>64</sup> As the MTC states in its ALAS Project Design, "Estimates of the federal revenue loss from international income shifting suggest that those losses approach \$100 billion annually. Assuming that is the case, state revenue losses would be nearly \$20 billion a year."<sup>65</sup>

### ARE THE REVENUE LOSS ESTIMATES CREDIBLE?

These are truly breathtaking revenue loss estimates. But the question remains—are they credible? Are they backed up by reasonable economic data on the actual behavior of multinational companies in the global marketplace and their impact on state taxation? The primary source for the U.S. PIRG estimates is a study that was done by economist Kimberly Clausing in 2009 and then updated in 2011.<sup>66</sup> Clausing did not attempt to break down the impact of profit shifting at the state level, but rather focused only on the federal level. Her study determined that multinational corporation income-shifting resulted in lost *federal* tax revenues in the (upper) range of about \$90 billion in 2008.<sup>67</sup>

Clausing's methodology is designed to identify the responsiveness of reported foreign affiliate profitability to *tax rate* differentials. However, the publicly available data she uses to estimate income shifting aggregates all the affiliates of U.S. parents operating in a country. As a result, the regression analysis cannot identify and incorporate firm-specific real economic factors that may explain a significant portion of observed variations in profitability.<sup>68</sup> Clausing thus assumes that the explanation for higher-than-average rates of profitability of foreign affiliates of U.S. multinationals is income shifting in response to tax rate differentials. Under her approach, Clausing makes no allowance for any high-profit, real economic activity that occurs in a lower tax jurisdiction because of business investment and resource allocation decisions. Clausing derives her "income shifting" estimates from the difference between the level of profit that would have been reported in a country if U.S. corporate income tax rates were levied, compared with the profit that was actually reported.<sup>69</sup>

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<sup>64</sup> Multistate Tax Commission, Design for an MTC Arm's-Length Adjustment Service, 3 (May 7, 2015), available at <http://www.mtc.gov/getattachment/The-Commission/Committees/Executive-Committee/Executive-Committee-Agenda-5-2015/Final-Design-for-ALAS-2015-04-30.pdf.aspx>.

<sup>65</sup> Id.

<sup>66</sup> See Schneider et al., *supra* note 61, at 22; Baxadnall et al., *supra* note 62, at 25.

<sup>67</sup> Kimberly A. Clausing, The Revenue Effects of Multinational Firm Income Shifting, Tax Notes, 28 March 2011, 1580–86. Clausing revised these estimates to \$77 billion to \$111 billion in federal revenue loss for 2012. Kimberly A. Clausing, "The Effect of Profit Shifting on the Corporate Tax Base in the United States and Beyond", November 2015, at 1. See also Clausing's earlier study: Kimberly A. Clausing, Multinational Firm Tax Avoidance and Tax Policy, National Tax Journal, December 2009, 703–725. It is also important to note that Clausing's estimate of the possible reduction in U.S. corporate income tax revenue is not an estimate of the amount of additional taxes that could be collected from tax policy changes to address income shifting behaviors. She notes, "...it is unlikely that the entirety of those revenues losses would be recouped through policy changes." Clausing, Revenue Effects, at 1586.

<sup>68</sup> As pointed out in the OECD study, Measuring and Monitoring BEPS, at 99, the vast majority of more recent studies of income shifting have used firm-level data that allows researchers to simultaneously estimate the separate impacts of firm-specific tax and non-tax factors on profitability. The results from firm-level studies tend to provide lower estimates of income shifting in response to profit differentials. It should also be noted that a shortcoming of almost all of these empirical studies is that they are based on book income and not taxable income, the measure that actually determines a firm's tax liability. OECD (2015), Measuring and Monitoring BEPS, Action 11—2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

<sup>69</sup> Clausing, Revenue Effects, *supra* note 67, at 1583. Clausing assumes that profitability within an enterprise should be the same across countries—regardless of the variations in corporate risk or value added activities—and that a deviation within a company from this average is a symptom of income shifting.

**The problem with the Clausing approach...**is the difficulty of separating the BEPS effect from the impact of real economic factors such as investment or resource allocation decisions made to take advantage of targeted tax incentives or lower tax rates.

The problem with the Clausing approach, as with similar studies, is the difficulty of separating the BEPS effect from the impact of real economic factors such as investment or resource allocation decisions made to take advantage of targeted tax incentives or lower tax rates. The OECD in its own efforts to measure the scale of BEPS highlighted the limitations of tax revenue loss studies and concluded, "...all analyses of BEPS are severely constrained by the limitations of the currently available data. The available data is not comprehensive across countries or companies, and often does not include actual taxes paid. **In addition to this, the analyses of profit shifting to date have found it difficult to separate the effects of BEPS from real economic factors and the effects of deliberate government tax policy choices**" (emphasis added).<sup>70</sup>

Ironically, for all the fury and fulmination accorded the "tax haven" issue by U.S. PIRG, the Clausing analysis is not based exclusively on tax haven nations. Rather, her analysis is inclusive of approximately 60 countries worldwide where U.S. multinationals primarily operate, most with lower tax rates than the U.S., since the U.S. has one of the highest corporate tax rates in the world.<sup>71</sup>

Despite its limitations, the Clausing analysis forms the basis for the PIRG state corporate income tax loss estimates attributable to tax havens. U.S. PIRG takes the high end of the Clausing analysis of \$90 billion of losses in federal income tax revenues due to BEPS (she also has a lower range number of \$57 billion which PIRG ignores<sup>72</sup>) and then extrapolates the number to create an estimate for state tax revenue loss, after taking into account differences in state and federal income tax rates, tax base and allocation of income. This ultimately results in its \$20 billion revenue loss estimate (previously \$26 billion).<sup>73</sup>

The vast overstatement of state corporate income tax losses forecast by the U.S. PIRG methodology becomes apparent when the estimate is compared to the global BEPS tax revenue loss estimate provided by the OECD BEPS project. In its study, the OECD concluded (subject to qualifications about serious data limitations) that global corporate revenue losses attributable to BEPS were in the range of 4 percent to 10 percent of global corporate income tax revenues.<sup>74</sup> By contrast, the U.S. PIRG estimate suggests that the state corporate income tax losses attributable to profit shifting to foreign tax havens total over 40 percent of all state corporate income tax revenue. In fiscal year 2012, the combined corporate income tax revenue of all 50 states totaled \$49.1 billion. Thus, based on U.S. PIRG's revenue loss estimate of \$20.7 billion for the same year, the use of tax havens to shelter corporate income was costing states an

<sup>70</sup> See OECD, Measuring and Monitoring, supra note 68, at 16. See also, Dhammika Dharmapala, "What Do We Know About Base Erosion and Profit Shifting? A Review of the Empirical Literature," (Coase-Sandor Institute for Law & Economics Working Paper No. 702, 2014). The Dharmapala paper provides a survey of the empirical literature on BEPS and concludes, "A major theme that emerges from this survey is that in the more recent empirical literature, which uses new and richer sources of data, the estimated magnitude of BEPS is typically much smaller than that found in earlier studies."

<sup>71</sup> See generally, Clausing, Revenue Effects, supra note 67, at 1585 (Analyzing tax rates throughout the world, and noting that the U.S. corporate tax rate is "more than one standard deviation higher than the average OECD country corporate tax rate").

<sup>72</sup> See id. (stating, "(a)n alternative estimate is also provided, suggesting a \$57 billion revenue loss associated with income shifting, or about 19 percent of U.S. government corporate tax revenues.").

<sup>73</sup> Baxadnall et al., supra note 62, at 3.

<sup>74</sup> See OECD, Measuring and Monitoring, supra note 68, at 15. The OECD concluded: "Although measuring the scale of BEPS proves challenging given the complexity of BEPS and the serious data limitations, today we know that the fiscal effects of BEPS are significant. The findings of the work performed since 2013 highlight the magnitude of the issue, with global corporate income tax (CIT) revenue losses estimated between 4% and 10% of global CIT revenues, i.e. USD 100 to 240 billion annually."

amount equal to 42.2 percent of the entire state corporate income tax base—**or 4 to 10 times higher than the OECD estimate range.**<sup>75</sup>

The credibility of the U.S. PIRG estimate is further undermined because it incorrectly purports to be attributable solely to “tax haven” countries, not to the BEPS impact in all nations where U.S. multinationals operate as measured by the Clausing study. For instance, in its June 2014 study, PIRG states, “By booking profits to subs registered in tax havens, multinational corporations are able to avoid an estimated \$90 billion in federal income taxes each year.”<sup>76</sup> This statement is not a correct description of Clausing’s empirical results.

### THE SHRINKING REVENUE LOSS ESTIMATES

However, perhaps the best refutation of the U.S. PIRG estimate of \$20 billion in state corporate income tax revenue losses attributable to tax havens comes not from a critique of the Clausing study, but from a subsequent study by U.S. PIRG itself. In 2014, U.S. PIRG published a study of the potential for additional state tax revenues if states enacted tax haven legislation.<sup>77</sup> In this study, U.S. PIRG concluded that such legislation would result in additional state tax revenues of only \$1.680 billion for all states with corporate income taxes.<sup>78</sup> Looking only at the subset of states with existing combined reporting requirements, U.S. PIRG estimated that additional state tax revenues of \$1.015 billion would result.<sup>79</sup>

This second study was based on the actual and estimated results of the two states (Montana and Oregon) with tax haven legislation that require income earned by foreign subsidiaries in designated tax haven countries to be included in the water’s-edge base for purposes of calculating state corporate income taxes. The results in Montana and Oregon were taken and then extrapolated across the remainder of states—with adjustments made for different corporate apportionment formulas and state tax rates.<sup>80</sup>

Incredibly, the state revenue “gain” estimates based on the second U.S. PIRG study total only **8.4 percent** of the estimated revenue “loss” estimates in the earlier U.S. PIRG study. Even more disturbing, U.S. PIRG, to date, has made no effort to **disavow** the earlier revenue estimate. Instead, it continues to use the \$20 billion estimate in its 2014 study and in a subsequent 2015 study, with no reasonable explanation of the differences between the two estimates, and no examination of the continuing legitimacy, if any, of the

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<sup>75</sup> See COST and Ernst & Young, FY13 Total State and Local Business Taxes: August 2014, p. 13; Baxadnall et al., supra note 62, at 7. If one uses the earlier estimate of \$26 billion, the use of tax havens to shelter corporate tax income was costing states an amount equal to 53 percent of the entire corporate income tax base. See also Schneider et al., supra note 61, at 10.

<sup>76</sup> Richard Phillips et al., Offshore Shell Games 2014: The Use of Offshore Tax Havens by Fortune 500 Companies, U.S. PIRG Education Fund and Citizens for Tax Justice, June 2014, at 1.

<sup>77</sup> See Baxadnall et al., supra note 62.

<sup>78</sup> See id., at 2.

<sup>79</sup> Id. at 21.

<sup>80</sup> Id. at 16–18.

**The OECD BEPS project...** is likely to result in a fundamental change in international tax rules and a significant diminution of profit shifting activities in low tax jurisdictions... state efforts to engage in self-help through adoption of tax haven lists appear increasingly out of step.

larger revenue estimate.<sup>81</sup> U.S. PIRG continues to assert in its April 2015 study, “Corporate tax haven abuse costs state governments an estimated \$20 billion in lost tax revenue.”<sup>82</sup>

The point here is not that the second and lower revenue estimate should be accepted at face value—far from it. This second PIRG study has its own set of problems. It is built upon real data from only one unique (and small population) state (Montana), and *estimated* data from a second small state (Oregon) which in turn based its estimate solely on Montana. These states rank 44<sup>th</sup> and 27<sup>th</sup> among U.S. states based on population, respectively.<sup>83</sup> Moreover, the second study attempts to determine the revenue estimate for the large number of “single sales” factor states based on the very thin foundation of Oregon’s estimated data. [Unlike Montana’s three-factor property, payroll and sales formula, Oregon only uses sales to determine the proportion of business conducted in the State.] However, even if one does not treat the second and drastically lower U.S. PIRG revenue loss estimate as entirely accurate, the second study certainly serves the purpose of highlighting the vast overstatement of revenue losses contained in the first and larger estimate.

Fiscal estimates for tax haven proposals in other states underscore the uncertainty in the fiscal effects of these measures and the unreliability of U.S. PIRG’s estimates. For example, the District of Columbia estimated its proposed adoption of a tax haven list of nations would net the District \$3.7 million in FY 2017.<sup>84</sup> By contrast, U.S. PIRG put its original “tax haven” revenue estimate for D.C. at \$284 million and its new, lower revenue estimate at \$17.9 million.<sup>85</sup> Likewise, New Hampshire estimated its tax haven proposal would net the state approximately \$5.1 million annually beginning in FY 2016, far less than U.S. PIRG’s original “tax haven” revenue estimate of \$98 million or its new, lower revenue estimate of \$26.1 million.<sup>86</sup>

An additional problem with the second U.S. PIRG study is that the estimates are necessarily based on “old” data of prior tax years and not necessarily predictive of future tax years. Indeed, it would be an error to assume that the financial impact of BEPS is a stationary target. The OECD BEPS project—the most significant undertaking of its kind

<sup>81</sup> Id. at 7, 20. See also Robert S. McIntyre et al., *supra* note 60, at 6. U.S. PIRG’s October 2015 study again approvingly references the \$90 billion Clausen estimate. It could be argued that the second and lower revenue estimate in the 2014 study is understated because Montana and Oregon do not include all of the nations U.S. PIRG considers to be tax haven countries in their statutory lists for inclusion in the water’s-edge income tax base. However, at most, this difference could only account for a modest fraction of \$18.4 billion difference between the estimates. The only half-hearted attempt U.S. PIRG makes at distinguishing the revenue estimates is by labeling its charts differently, calling the larger revenue loss estimate chart “State-by-State Tax Revenue Lost to Offshore Tax Havens”; and the smaller revenue loss estimate chart “State-by-State Potential Additional Tax Revenue Collected by Closing the Water’s Edge Loophole”. See Baxadnall et al., *supra* note 62, at 20–21. However, even though state tax haven legislation is the primary legislative solution recommended by U.S. PIRG to combat income tax shifting to foreign jurisdictions, the organization makes little effort to reconcile the drastically different revenue estimates.

<sup>82</sup> Jaimie Woo & Dan Smith, *supra* note 63, at 1.

<sup>83</sup> U.S. Census Bureau, Annual Estimates of the Resident Population for the United States, April 1, 2010 to July 1, 2015, available at <https://www.census.gov/popest/data/state/totals/2015/index.html>.

<sup>84</sup> Jeffrey Dewitt, Memorandum from Jeffrey S. Dewitt, Chief Financial Officer, to The Honorable Phil Mendelson, Chairman, Council of the District of Columbia, June 29, 2015, at 60, available at [http://app.cfo.dc.gov/services/fiscal\\_impact/pdf/spring09/FIS%20-%20Fiscal%20Year%202016%20Budget%20Support%20Act%20of%202015r.pdf](http://app.cfo.dc.gov/services/fiscal_impact/pdf/spring09/FIS%20-%20Fiscal%20Year%202016%20Budget%20Support%20Act%20of%202015r.pdf).

<sup>85</sup> See Baxadnall, *supra* note 62, page 20–21.

<sup>86</sup> Fiscal Impact Statement, New Hampshire Department of Revenue Administration, re: H.B. 2, sent to Legislative Budget Assistant’s Office (LBAO) on March 10, 2015. See Baxadnall, *supra* note 62, page 20–21.

in the last 100 years<sup>87</sup>—is likely to result in a fundamental change in international tax rules and a significant diminution of profit shifting activities in low tax jurisdictions.<sup>88</sup> Thus, even if one accepts at face value the lower estimates of potential state tax revenue losses cited in the second U.S. PIRG study, these projections will likely become outdated soon after their release. In this context, state efforts to engage in self-help through adoption of tax haven lists appear increasingly out of step.

The purpose of critiquing the U.S. PIRG and related studies is not to suggest there is no profit shifting occurring in a complex global economy characterized by significant national differences in corporate tax rates and corporate tax incentives, oft-conflicting rules on how to tax cross border commerce, and ample opportunities for companies to develop tax efficient corporate structures. The nations involved in the OECD project are in agreement that base erosion and profit shifting (BEPS) is a significant issue that must be addressed—at least at the international level. But arbitrarily and irresponsibly assigning a very large state tax revenue loss estimate to the problem does not help inform state and local tax policymakers on how to approach the issue on a going forward basis. It simply stirs up emotional rhetoric and a hue and cry for overreaching and simplistic solutions such as state tax haven legislation rather than focusing on the much thornier underlying issues of how to best align the reporting of corporate profits with where value is created.

Finally, even if one assumes a certain level of profit shifting at the international level, that still leaves open the question of whether the states have any reasonable claim to this income. The BEPS project has been driven less by the U.S. than by other large industrialized countries in Europe and Asia. These nations believe the division of multinational cross border income has adversely impacted their own tax bases. These nations are not supporting the BEPS project because they believe global income has been insufficiently sourced to the United States (at the national and subnational levels), but rather that it has been insufficiently sourced to their own countries.<sup>89</sup>

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<sup>87</sup> Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project, OECD 2015, at 5. Given the widespread support accorded to the OECD BEPS project's recommended action measures by the OECD and G-20 nations that account for over 90 percent of the world's GNP, there is a high likelihood that international tax rules will change dramatically over the next few years. This will undoubtedly have the effect of placing a significant downward pressure on any tax revenue losses from BEPS both at the global level and at the state and local level. According to the overview provided by the OECD in its recently released 2015 summary of the OECD/ G20 Base Erosion and Profit Shifting Project:

"Out of a shared desire to address BEPS concerns, there is agreement on a **comprehensive package of measures** which are designed to be implemented domestically and through treaty provisions in a coordinated manner, supported by targeted monitoring and strengthened transparency. The goal is to tackle BEPS structures by comprehensively addressing their root causes rather than merely the symptoms....The BEPS package represents the first substantial—and overdue—renovation of the international tax standards in almost a century...The G20 and the OECD have recognized that BEPS by its very nature requires coordinated responses, which is why countries have invested the resources to participate in the development of shared solutions." Id. at 5.

<sup>88</sup> See Deloitte, OECD's Base Erosion and Profit Shifting (BEPS) Initiative: Full Results of Second Annual Multinational Survey, May 2015, available at <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-beeps-full-survey-results-may-2015.pdf>. Moreover, it is not just the world's leading nations that are anticipating that far-reaching changes will take place in the international tax arena because of the OECD BEPS reforms. Multinational companies are also fully expecting a major overhaul to international tax rules that will more closely align the location of taxable profits with the location of economic activities and value creation. According to a 2015 Deloitte Survey of tax and finance leaders of multinational companies:

- 87 percent of the respondents agree or strongly agree that the BEPS initiative will result in significant legislative and treaty changes in many countries.
- 96 percent of the respondents agree or strongly agree that tax authorities will apply greater scrutiny around the level of substantive business operations conducted in low tax countries as a result of BEPS initiatives.
- 58 percent of respondents agree or strongly agree that the BEPS project will have a greater impact on their organizations than they originally thought. Id. at 21, 22, & 24.

<sup>89</sup> Joe Harpaz, Congress Girds for a Showdown Over Global Tax Plan, Forbes.com, June 11, 2015.

...where is the evidence that corporate profit shifting to offshore tax havens is sharply reducing the level of state and local taxes paid by business...?

So in addressing what share, if any, the states should be entitled to, it is necessary to answer several key questions. To what extent is the problem attributable to income that is shifted among different foreign nations with minimal connection to any underlying economic activities in the U.S.? Does the income have any reasonable connection to individual states that would justify a state expanding its income tax base to include the foreign source profits? And finally, where is the evidence that corporate profit shifting to offshore tax havens is sharply reducing the level of state and local taxes paid by business and causing a gaping hole in the state and local tax base?

### THE BUSINESS SHARE OF STATE AND LOCAL TAXES IS ACTUALLY INCREASING

For U.S. PIRG and other proponents of state tax haven legislation, highlighting state revenue losses allegedly caused by profit shifting to tax havens is really part of a broader criticism: businesses do not pay their “fair share” of state and local taxes. As stated by U.S. PIRG in its 2014 tax haven study, “Every person and every corporation in America benefits from government services—from schools to paved roads to courts and public health. We all should contribute our share in taxes when it comes to paying the tab. Yet even though America’s corporations use these government services, many avoid paying taxes for them by moving their profits into offshore havens.”<sup>90</sup>

However, the assertion that businesses do not pay their fair share of state and local taxes is based on a fundamental misunderstanding (or intentional distortion) of both the composition and level of business contributions to state and local government revenues. To begin, criticism of corporations for not paying their fair share almost always focuses exclusively on state and local corporate income taxes.<sup>91</sup> However, the corporate income tax generally makes up less than one-tenth of all state and local taxes paid by business.<sup>92</sup>

In FY2014, of the \$688 billion in state and local taxes paid by businesses, only \$64.4 billion was from corporate income taxes (and other business activity taxes), representing 9.4 percent of the total.<sup>93</sup> By comparison, in that same year, property taxes on business property accounted for 36.4 percent of all state and local business taxes, and sales taxes on business inputs made up 20.7 percent of total state and local business taxes (see Figure 2).<sup>94</sup>

<sup>90</sup> Baxadnall et al., *supra* note 62, at 4.

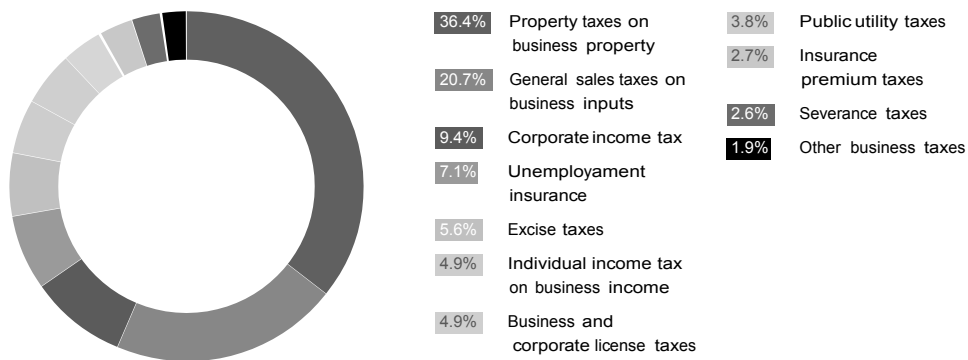
<sup>91</sup> See generally, Council On State Taxation, Updated Citizens for Tax Justice Report Misleads Policymakers and the Public, Mar. 31, 2014, available at <http://www.cost.org/WorkArea/DownloadAsset.aspx?id=86913>.

<sup>92</sup> State and local government are not unique in their limited reliance on corporate income taxes as a source of government revenue. Among OECD countries, the corporate income tax only accounts for 8% of all tax revenues on average. Many economists view the corporate income tax as a possible detriment to economic growth and an inefficient and cumbersome way to raise revenues for government as compared with consumption and property taxes. OECD, Revenue Statistics 2015, Dec. 2015, at 29 available at <http://www.oecd.org/ctp/tax-policy/revenue-statistics-19963726.htm>.

<sup>93</sup> Council On State Taxation and Ernst & Young, Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2014, Oct. 2015, at 2. This total includes revenue from the Ohio Commercial Activity Tax, Washington’s B&O Tax, New Hampshire’s Business Enterprise Tax and the Texas Franchise (Margin) Tax. All serve as proxies in their respective states for a corporate income tax.

<sup>94</sup> *Id.* at 3.

FIGURE 2. TOTAL STATE AND LOCAL BUSINESS TAXES, FY 2014



...since 2000, the overall share of state and local taxes paid by businesses has remained stable, generally within 1 percentage point of 45 percent of all state and local taxes paid each year...

Thus, property taxes and sales taxes on business inputs are far more important sources of state and local tax revenue than corporate income taxes. Taxes on business property account for 54 percent of all state and local property taxes.<sup>95</sup> Taxes on business inputs make up 42 percent of all state and local sales tax revenue.<sup>96</sup> Overall, state and local business taxes account for 45 percent (\$688.7 billion) of all state and local tax revenue (\$1,531.4 billion).<sup>97</sup>

Moreover, the implication that base erosion and profit shifting to foreign “tax havens” has decimated the business contribution to state and local taxes is also contradicted by the stability and even upward trend line of the business share of overall state and local taxes. According to Clausing’s analysis, the period since 2000 has been the peak period of corporate base erosion and profit shifting—with about 85 percent of the alleged rise in annual revenue loss occurring during that period.<sup>98</sup> Nonetheless, since 2000, the overall share of state and local taxes paid by businesses has remained stable, generally within 1 percentage point of 45 percent of all state and local taxes paid each year (see Figure 3).<sup>99</sup> Indeed, the share of state and local taxes paid by businesses is actually higher in FY2014 (45 percent) than it was in FY2000 (42.6 percent), and above the average for the period since FY2000 (see Figure 3).<sup>100</sup>

The aggregate level of state and local taxes also increased over this 15-year period—so the rising business share was of a bigger “pie”. Total state and local taxes increased from \$370.9 billion in FY2000 to \$688.7 billion in FY2014, a real increase of about 35 percent after taking inflation into account.<sup>101</sup>

<sup>95</sup> Id. at 4.

<sup>96</sup> Id. at 3.

<sup>97</sup> Id. at 4.

<sup>98</sup> Clausing, Revenue Effects, supra note 67, at Figures 4 and 5.

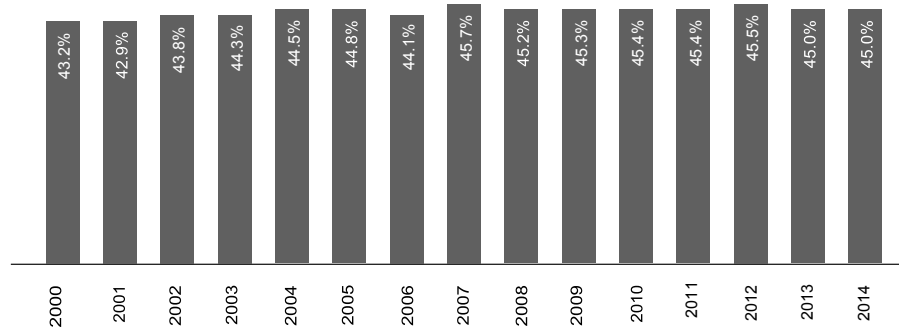
<sup>99</sup> COST/EY, supra note 93, at 1.

<sup>100</sup> See generally, COST/EY, Business Tax Burden Studies, available at www.cost.org. Similarly, contrary to the notion that corporations do not pay their fair share of taxes relative to the benefits they receive, business taxes average 3.35 times more than net government spending that benefits businesses (or 1.2 times if 50 percent of educational expenses are allocated to business). COST/EY, supra note 93, at 2.

<sup>101</sup> See generally, COST/EY, Business Tax Burden Studies, available at www.cost.org.

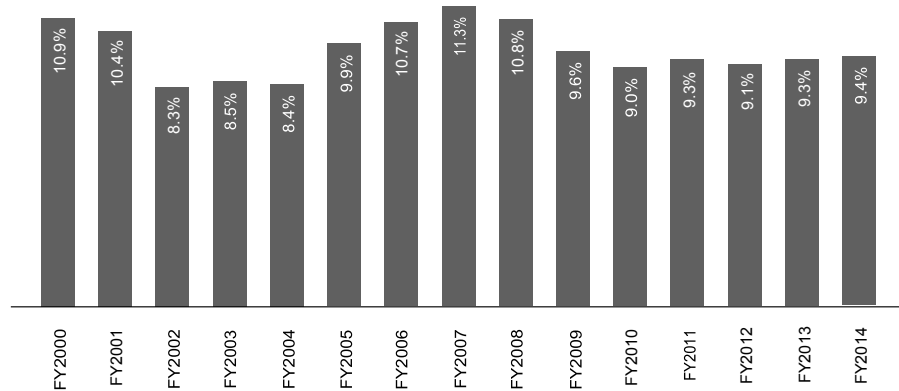


FIGURE 3. SHARE OF STATE AND LOCAL TAXES PAID BY BUSINESSES



The corporate income tax and other business activity taxes—although comprising less than 10 percent of overall state and local taxes paid by business—have also been relatively stable over the last 15 years, ebbing and flowing primarily with the cycles of the U.S. economy (see Figure 4).<sup>102</sup>

FIGURE 4. STATE AND LOCAL CIT AND OTHER BUSINESS ACTIVITY TAX COLLECTIONS AS SHARE OF TOTAL STATE AND LOCAL BUSINESS TAX COLLECTIONS



Source: EY/COST Studies, "Total state and local business taxes," FY2000–2014.

<sup>102</sup> This statistic includes both the state corporate income tax and other business entity taxes including the Michigan Business Tax, the Ohio Commercial Activity Tax, the Texas Franchise/Margin Tax and the Washington B&O Tax. The fluctuations in the corporate income tax are attributable not only to business cycles, but also to other factors such as changes in corporate tax rates; reductions in the federal tax base (e.g., Section 199 and bonus depreciation); and the shift to pass-through entities (e.g., S Corporations and partnerships) that are taxed under the personal income tax. See generally, COST/EY, Business Tax Burden Studies, available at [www.cost.org](http://www.cost.org).

In conclusion, the impact on overall state and local taxes of any corporate profit shifting at the international level has been limited, and is more than offset by increases in other taxes paid by business. The business share of state and local tax revenues has actually increased slightly over the last fifteen years—belying the notion that corporate profit shifting to offshore havens has created a gaping hole in the state and local tax base. To be sure, it is within each state’s sovereign power to determine the overall level of taxes, the composition of taxes, and the relative share of taxes that should be paid by business and individuals. Nonetheless, tax policy decisions such as the consideration of tax haven legislation should be based on all of the relevant facts, and not on an oversimplified and distorted view of how much businesses pay in state and local taxes.

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**The business share** of state and local tax revenues has actually increased slightly over the last fifteen years—belying the notion that corporate profit shifting to offshore havens has created a gaping hole in the state and local tax base.

## STATE TAX HAVEN LEGISLATION REPRESENTS A PARTIAL RETURN TO A MANDATORY WORLDWIDE COMBINATION FILING METHOD

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...state tax haven legislation... represents an abandonment of the prevailing consensus among the states to limit the taxation of multinational companies to the “water’s edge”.

One of the biggest concerns with state tax haven legislation is that it represents an abandonment of the prevailing consensus among the states to limit the taxation of multinational companies to the “water’s edge”. Ever since the early 1980s, when the states backed away from the mandatory worldwide combination filing method, the water’s-edge principle has limited the state taxation of foreign corporations.

State corporate income tax regimes generally apply either on a separate entity or combined reporting basis (or some variation of consolidated filing). Combined reporting regimes include the unitary members of the taxpayer’s affiliated group.<sup>103</sup> Every state corporate income tax combined reporting regime of general application limits filing to the “water’s edge,” either as the default method or by taxpayer election.<sup>104</sup> The water’s-edge filing method generally includes domestic corporations and excludes foreign corporations.

There are, of course, variations to the water’s-edge rules. For example, some states exclude domestic corporations with less than 20 percent U.S. activity (the so-called 80/20 rule), while other states include income of foreign affiliates with more than 20 percent U.S. activity (a kind of reverse 80/20 rule). Some states include in the water’s-edge tax base Subpart F income and income of non-U.S. affiliates earning a certain percentage of income from intangible property or service-related activities. Some states require the “addback” of payments to foreign affiliates for royalties and/or interest “earned” in the United States. States may also limit the percentage deduction available for foreign dividends. None of these provisions, however, seeks to take in the income of foreign affiliates *per se* without respect to U.S. activity or income.

States that expand their combined reporting regimes to encompass foreign corporations incorporated in or doing business in “tax haven” jurisdictions generally include these foreign income streams within existing “water’s-edge” statutes. However, this rhetorical sleight of hand cannot conceal that tax haven statutes violate the water’s-edge concept—

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<sup>103</sup> William Fox & LeAnn Luna, Combined Reporting with the Corporate Income Tax: Issues for State Legislatures, NCSL, November 2010, at iii & iv, available at <http://www.ncsl.org/documents/standcomm/sccomfc/combinedreportingfinaldraft.pdf>.

<sup>104</sup> *Id.* at 16–17.

operating in the same manner as mandatory worldwide combination filing statutes, albeit with the income from some but not all foreign countries included in the state's tax base.

## MANDATORY WORLDWIDE FILING ABANDONED BY THE STATES SINCE THE 1980s

Approximately twelve states employed mandatory worldwide combined reporting as of 1984.<sup>105</sup> However, in a series of actions beginning in 1984 and accelerating over the next few years, these states all reverted to the water's-edge limitation, a position that has held ever since.<sup>106</sup>

Pressure against mandatory worldwide combination had been building through the 1970s and early 1980s among both foreign governments and foreign and domestic multinational business enterprises, threatening to instigate an international tax war. The British and Japanese governments in particular took action to counter the trend toward mandatory worldwide combination filing. In 1985, the British Parliament passed legislation enabling the British Treasury to retaliate against U.S. corporations in response to the worldwide unitary tax regimes in California and other states.<sup>107</sup> Commentators at the time noted the retaliatory measure was adopted only after "exhaustive political efforts to persuade states to repeal their use of the worldwide unitary tax," and a Member of Parliament believed the measure would cause U.S. companies to "press and lobby hard their state...and federal government[s] to...clear up the issue of the unitary tax."<sup>108</sup>

Soon after the U.S. Supreme Court in 1983 decided *Container Corp.*,<sup>109</sup> upholding California's imposition of worldwide combined reporting on a domestic parent and its foreign subsidiaries, the U.S. business and international community pressure came to a head, spurring President Ronald Reagan to convene the Worldwide Unitary Taxation Working Group. As described in the introduction to the Working Group's Final Report, "In the wake of the *Container* decision, members of the business community and major trading partners of the United States renewed their objections to the worldwide unitary tax method and urged the Administration to: (1) file a memorandum with the Supreme Court as *amicus curiae* in support of a rehearing in the *Container* case; and (2) support federal legislation that would limit or prohibit worldwide unitary taxation."<sup>110</sup>

Ultimately, Treasury Secretary Donald Regan announced the administration's decision to refrain from supporting the motion for rehearing in *Container* and instead to establish the Working Group composed of representatives of the federal government, state governments, and the business community. The Working Group was "charged with producing recommendations...that will be conducive to

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<sup>105</sup> See Dept. of the Treasury, The Final Report of the Worldwide Unitary Taxation Working Group, Aug. 1984, at 1, available at <http://www.oost.org/WorkArea/DownloadAsset.aspx?id=82785>.

<sup>106</sup> See Walter Hellerstein, Designing the Limits of Formulary Income Attribution Regimes, 2014 STT 36-62 (2014). Professor Hellerstein's research details how, beginning in 1984, "states acted with unusual legislative speed" to repeal worldwide combined filing, ending with Alaska's adoption of water's-edge legislation for most companies in 1991. Id. at 57.

<sup>107</sup> Sec. 54, Finance Act 1985, reprinted in New Clause 27, 1985 Finance Bill, 1355 Parl. Deb., H.C. 1014 (1985). See Robert D. Wallingford, British Retaliation Against the California Unitary Tax: The Needed Impetus for a Federal Solution, 8 J. Comparative Bus. & Cap. Market L.345-371 (1986).

<sup>108</sup> Id.

<sup>109</sup> *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983).

<sup>110</sup> Dept. of Treasury, *supra* note 105, at 3.

harmonious international economic relations, while also respecting the fiscal rights and privileges of the individual states.”<sup>111</sup>

### LAYING THE GROUNDWORK FOR THE WATER’S-EDGE STANDARD

Not surprisingly, the Working Group did not easily come to consensus. In fact, the Working Group failed to reach agreement on any of the six options drafted by a “technical-level Task Force composed of representatives of the Working Group members to thoroughly review the issues and develop options for decision by the Working Group.”<sup>112</sup> Ultimately, these “options” reflected a fundamental disagreement with respect to treatment of foreign dividends and “80/20” companies, and the disagreement proved too great to bridge.

However, the Working Group did agree “on a set of principles that should guide the formulation of state tax policy”:

- 1) “Water’s-edge unitary combination for both U.S. and foreign based companies”; 2) “Increased federal administrative assistance and cooperation with the states to promote full taxpayer disclosure and accountability”; and 3) “Competitive balance for U.S. multinationals, foreign multinationals, and purely domestic businesses.”<sup>113</sup>

The state and business members of the Working Group, predictably, did not agree on how these principles might be applied.<sup>114</sup> With respect to the water’s-edge recommendation, business representatives asserted that “the water’s-edge concept is acceptable to U.S. based multinationals only if it does not result in the conversion of foreign source income received in the form of dividends into domestic income of the ‘water’s-edge’ group.”<sup>115</sup>

Nonetheless, the failure of the states to adhere to the water’s-edge reporting principle prompted the Treasury in 1985 to propose legislation preempting worldwide combination.<sup>116</sup> The states ultimately responded to this threat by repealing their mandatory worldwide regimes. Thus, the Working Group’s Final Report and the ensuing response set in motion a consensus of water’s-edge reporting that has held for nearly 30 years.

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<sup>111</sup> Id. at 3–4.

<sup>112</sup> Id. at 5.

<sup>113</sup> Id. at 5–6.

<sup>114</sup> For example, according to the Final Report, “The business group endorses the above Principles only with respect to those states whose tax practices are in compliance with Principles One and Three. The state group endorses the above Principles only with the understanding that Principle One is conditioned on compliance with Principles Two and Three.” Id. at 10.

<sup>115</sup> See id.; Final Working Group Report, Statement by the Business Representatives on the Worldwide Unitary Taxation Working Group, Aug. 31, 1984, at 2. The concept of “tax havens” was included in certain options considered by the Worldwide Unitary Taxation Working Group in 1984. However, this concept never emerged as a consensus recommendation of the working group, and the working group specifically did not agree on how to define a “tax haven.” The business representatives were willing to at least discuss the “tax haven” concept because they were more concerned with the larger threat posed at that time by mandatory worldwide combination. See Dept. of Treasury, *supra* note 105.

<sup>116</sup> See Hellerstein, *supra* note 106.

## ADOPTING TAX HAVEN STATUTES BREAKS THE WATER'S-EDGE CONSENSUS, INVITES CONTROVERSY AND BUSINESS DISINVESTMENT

The rising tide of state tax haven legislation (both enacted and proposed) is proliferating a selective form of worldwide combined reporting that threatens to break the water's-edge consensus. As noted, foreign nations actually authorized retaliatory tax treatment against U.S. multinationals in response to worldwide combined reporting. Similarly, individual foreign nations, as well as groups of foreign nations (*e.g.*, the Caribbean Community Caucus of Ambassadors), have objected vehemently to their inclusion in state tax haven legislation. California rejected tax haven proposals after thoroughly studying the issue and receiving testimony from multiple affected nations.<sup>117</sup> In 2015, Ireland's Consul General testified in Augusta, Maine against Maine tax haven legislation,<sup>118</sup> and the Netherlands' Consul General, members of the Ministry of Finance, and other national representatives testified against an expansion of Oregon's tax haven list in Portland, Oregon.<sup>119</sup> In each case, the affected nations persuaded legislators not to include them in a tax haven list.

While states have thus far been largely unsuccessful in expanding tax haven lists to include key U.S. trading partners such as the Netherlands, Ireland, Switzerland and Hong Kong, the continued attempts to do so have heightened business concerns that state tax haven legislation is just a stalking horse for a return to mandatory worldwide combination.<sup>120</sup> To be sure, there is currently no substantial movement among the states for the return of mandatory worldwide combination. However, the impetus to expand the tax haven list is driven by the realization there is not enough money to be gained by just picking on island economies. According to U.S. PIRG's own estimates of the "Profits Reported Collectively by American Multinational Corporations in 2010 to 12 Notorious Tax Havens", two-thirds of these profits were booked to the following five countries: Netherlands, Ireland, Switzerland, Luxembourg and Singapore.<sup>121</sup> This explains why some of the states are so determined to add these larger countries to their lists—despite the more controversial nature of their inclusion.

The efforts to broaden the tax haven lists to include additional countries have been criticized for some of the same reasons as those invoked in the 1970s and 1980s in relation to mandatory worldwide combination, but also for reasons unique to tax haven lists. A letter from the Organization for International Investment (OFII) to Oregon underscores the concerns these proposals have generated with respect to foreign direct investment (FDI) in the United States:

“This tax policy would misalign with economic development efforts to attract investment directly from any company based in or with affiliates in the listed nations.

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...state tax haven legislation is just a stalking horse for a return to mandatory worldwide combination.

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<sup>117</sup> Water's Edge: California Jobs and International Investment Opportunities: Informal Hearing before the S. Select Comm. on California-European Trade, (Cal. May 19, 2010), available at [http://caleuropeantrade.senate.ca.gov/sites/caleuropeantrade.senate.ca.gov/files/Waters\\_Edge\\_CA\\_Jobs\\_and\\_International\\_Investment\\_Opportunities\\_5-19-2010.pdf](http://caleuropeantrade.senate.ca.gov/sites/caleuropeantrade.senate.ca.gov/files/Waters_Edge_CA_Jobs_and_International_Investment_Opportunities_5-19-2010.pdf).

<sup>118</sup> See Douglas Rooks, Bill Sponsor Open to Changes in Maine Tax Haven Legislation, 2015 STT 46-3 (Mar. 10, 2015).

<sup>119</sup> See Hearing before H. Comm. on Revenue (Or. March 25, 2015), available at [http://oregon.granicus.com/MediaPlayer.php?clip\\_id=8822](http://oregon.granicus.com/MediaPlayer.php?clip_id=8822).

<sup>120</sup> Along these lines, the featured speaker at the 2014 Multistate Tax Commission Annual Meeting was Edward Kleinbard, a law professor who advocated mandatory worldwide combination as the best solution for addressing the BEPS problem at the state level. See Multistate Tax Commission, 47th Annual Conference & Committee Meetings: Schedule of Events, available at <http://www.mtc.gov/Events-Training/2014/47th-Annual-Conference-Committee-Meetings>.

<sup>121</sup> Richard Phillips et al., *supra* note 76, at 14.

No state has ever blacklisted the Netherlands or Switzerland...major U.S. trading partners and sources of FDI...[T]he state would be erecting barriers to known sources of investment and job creation. Additionally, the uncertainty of which jurisdictions will be added to the list and the tax treatment other global companies receive in Oregon could hurt the state's outreach efforts across the globe."<sup>122</sup>

The letter also asserts the proposal undermines U.S. bilateral tax treaties and invites retaliatory legislation, noting "Oregon's policy is not far removed from California's aggressive tax approach in the 1980's that pursued all income of non-U.S. companies—including that which had nothing to do with U.S. business activities."<sup>123</sup>

The impact on foreign direct investment is accentuated by the overreach of state tax haven legislation in taxing foreign headquartered companies. Similar to worldwide combination, tax haven legislation makes no distinction between the taxation of corporate groups with domestic or foreign parents. Unlike the federal government, which only taxes foreign headquartered groups on their U.S. source income, states with tax haven legislation would sweep in the foreign source income of corporate groups with foreign parents.

Even a modest decline in FDI can have a significant impact on a state in terms of economic and employment growth. As of 2013, the cumulative value of FDI in the United States totaled \$2.8 trillion.<sup>124</sup> In 2013 alone, foreign direct investment in the 50 states totaled \$236.3 billion.<sup>125</sup> U.S. subsidiaries of foreign companies account for 18 percent of all U.S. manufacturing jobs, produce 21 percent of U.S. exports, and fund 15 percent of all private sector research and development.<sup>126</sup> According to a 2015 EY study, each dollar of foreign investment by U.S. multinational companies led to \$3.50 of additional domestic investment.<sup>127</sup>

States adopting tax haven legislation also expose themselves to backlash from U.S. multinationals, as evidenced in the recent tax policy debates in the District of Columbia and Connecticut. Taxes do matter to multi-jurisdictional companies—this premise is one of the key underpinnings of the BEPS project. Creating an environment in which a state is an "outlier" from other states and from most other nations is not sound tax policy. For instance, one recent National Bureau of Economic Research study found, "In this paper we have estimated economic responses to state-level business taxation by multi-State firms on both the extensive and intensive margins. We find evidence consistent with substantial responses of these firms to state tax rates for the relevant tax rules. Corporate entities reduce the number of establishments per state and the number of employees and amount of capital per plant when state tax rates increase."<sup>128</sup>

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<sup>122</sup> See Hearing Before H. Comm. on Revenue on H.B. 2099 (Or. 2015) (statement of Nany McLernon, President & Chief Executive Officer, Organization for International Investment), available at <http://ofii.org/sites/default/files/OFFI%20HB%202099Testimony%20Packet.pdf>.

<sup>123</sup> Id.

<sup>124</sup> Organization for International Investment, Foreign Direct Investment in the United States: 2014 Report, at 2, available at <http://www.ofii.org/sites/default/files/FDIUS2014.pdf>.

<sup>125</sup> Id. at 1.

<sup>126</sup> Organization for International Investment, Insourcing Facts, accessed on Jan. 19, 2016, available at <http://www.ofii.org/resources/insourcing-facts>.

<sup>127</sup> Ernst & Young, Buying and Selling: Cross-Border Mergers and Acquisitions and the US Corporate Income Tax, Mar. 2015, at 23.

<sup>128</sup> Xavier Giroud and Joshua Rauh, State Taxation and the Reallocation of Business Activity: Evidence from Establishment-Level Data, NBER Working Paper No. 21534, September 2015, at 36.

Of course, a state business climate is the by-product of a broad range of state tax policy choices including composition of taxes, overall tax burden on business, state marginal tax rates, tax administration, and state tax incentives or exemptions. Nonetheless, it would be irresponsible to ignore the potential negative economic impacts on a state's economy of a highly visible tax policy choice that could create a tipping point, such as a departure from the prevailing water's-edge consensus and extension of the corporate tax base to encompass foreign subsidiary income that is not effectively connected with a state.

The negative ramification of tax haven legislation is exacerbated by the fact that the only states that have so far adopted state tax haven legislation are small population states. To date, only seven states with a combined 13 million in population (or about four percent of total U.S. population) have adopted state tax haven proposals.<sup>129</sup> Thus, any state in the near future that adopts the tax haven approach will not only be out of sync with the OECD and the international community but also with the vast majority of states (including the largest 25 states as measured by population). Indeed, many states, including California, have already considered and rejected tax haven legislation.<sup>130</sup> The obvious peril here for more aggressive states is the potential for a competitive disadvantage relative to nearby states that remain within the water's-edge framework.

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**...it would be irresponsible to ignore the potential negative economic impacts on a state's economy of a highly visible tax policy choice that could create a tipping point, such as a departure from the prevailing water's-edge consensus...**

## CONSTITUTIONAL CHALLENGES TO TAX HAVEN LEGISLATION

State tax haven legislation will almost certainly face legal challenges as well. The prospects for a successful constitutional challenge were analyzed in an article by a leading state tax attorney, Joseph Donovan.<sup>131</sup> The article recognizes that under the U.S. Supreme Court's decision in *Japan Line*, two tests must be met before a state may tax foreign commerce: "whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation," and "whether the tax prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'"<sup>132</sup> While state worldwide combined reporting regimes ultimately withstood scrutiny under these tests, their application to the selective worldwide reporting standard of "tax haven" lists may not yield the same result, particularly given the arbitrary and punitive nature of the lists.

State tax haven laws designate foreign commercial enterprises in select nations for differential treatment, with the intent of increasing in-state tax liability. Unlike the worldwide combined method, which purports to tax the in-state activity of the entire unitary enterprise (whether domestic or foreign), tax haven laws designate nations by list or allow discretion to state revenue departments to apply criteria. In either case, only portions of the unitary business are included in the filing, with the intended result to create a punitive regime for those unitary businesses more active in the targeted jurisdictions. This is in distinct contrast to the worldwide unitary regime considered in *Container Corp. and Barclays*.<sup>133</sup>

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<sup>129</sup> U.S. Census Bureau, *supra* note 83.

<sup>130</sup> See California Select Committee on California-European Trade report, *supra* note 117.

<sup>131</sup> See Joseph X. Donovan and Anne N. Ross, *Unsafe Havens: Are Efforts to Extend State Tax Reach Beyond the Water's Edge Constitutional?*, 73 STT 661 (2014).

<sup>132</sup> *Id.* at 663, quoting *Japan Line Ltd. v. Los Angeles County*, 441 U.S. 434 (1979).

<sup>133</sup> *Barclays Bank PLC v. Franchise Tax Board*, 512 U.S. 298 (1994).



As Donovan points out, the state tax haven listing actions appear to implicate the Foreign Affairs Power Doctrine, representing “an intrusion by the State into the field of foreign affairs.”<sup>134</sup> Unlike in the worldwide combined context, tax haven statutes involve states investigating the sufficiency of foreign nations’ laws and designating certain nations for punitive treatment under that state’s laws. An analogous scenario was struck down by the U.S. Supreme Court in *Zschernig v. Miller*, 389 U.S. 429 (1968), in which Oregon barred nonresident aliens from inheriting property unless the nation of residence met certain standards established by *Oregon* for inheritance rights.<sup>135</sup> Like state tax haven statutes, this represented more than an “incidental or indirect effect in foreign countries”, and instead is the “kind of state involvement in foreign affairs and international relations matters which the Constitution entrusts solely to the Federal Government”.<sup>136</sup> The Court further found, “States, of course, have traditionally regulated the descent and distribution of estates. But those regulations must give way if they impair the effective exercise of the Nation’s foreign policy.”<sup>137</sup> Substituting “tax” for estate regulation would appear to yield the same result reached by the U.S. Supreme Court in *Zschernig*.

### OTHER STATE APPROACHES TO TAXING EFFECTIVELY CONNECTED FOREIGN SOURCE INCOME

States have employed other tools in their attempts to deal with perceived gaps in the corporate income tax base attributable to leakage to foreign countries. One common tool used by many states is an addback statute that adds back to income certain interest or intangible expense paid to a related member.<sup>138</sup> These statutes often contain exceptions meant to allow deductions for related party payments that do not distort reported state income. The addback statutes typically apply to payments made both to domestic affiliates and foreign affiliates, with specific exceptions (*e.g.*, treaty income) applicable to foreign payments.

Another state tax tool is the authority to adjust items of income under state provisions similar to I.R.C. Section 482. Most states have some authority to adjust arm’s length pricing between related parties. Indeed, interest in adding resources and expertise to state transfer pricing enforcement is building among the states. Other tools available to the states to address foreign source income include alternative apportionment authority; application of common law doctrines of business purpose and economic substance; expansive jurisdictional rules that apply to foreign entities doing business in the U.S.; and 80/20 rules imposed on foreign corporations with more than 20 percent of their factors in the U.S.

These state tax mechanisms share in common a focus on particular transactions and structures that states believe may not result in an adequate reflection of where income is earned. Regardless of the deficiencies in these various approaches, they avoid the all-or-nothing approach of blacklisting countries, which carries a high risk of taxing income not effectively connected to the jurisdiction and interfering with the authority of the federal government over foreign affairs.

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<sup>134</sup> Donovan & Ross, *supra* note 131, at 672, quoting *Zschernig v. Miller*, 389 U.S. 429 (1968).

<sup>135</sup> *Id.*

<sup>136</sup> *Id.* at 434–35, quoting *Clark v. Allen*, 331 U.S. 503, 517 (1947).

<sup>137</sup> *Zschernig v. Miller*, 389 U.S. 429, 440 (1968).

<sup>138</sup> See, *e.g.* N.J. Stat. Ann. §54-10A-4(k)(2)(i).

## STATE TAX HAVEN LEGISLATION IS OUT OF SYNC WITH THE GLOBAL APPROACH TO BEPS

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One of the biggest drawbacks of state tax haven legislation is it constitutes a “go-it-alone” approach largely inconsistent with the legislative and regulatory solutions being considered and adopted elsewhere in the world. Indeed, state enactment of tax haven legislation is completely out of sync with the approach recently taken by the OECD and G20 nations in the BEPS project. A review of the OECD/G20 analysis of the complexities of taxing corporate income on a global scale and of the recommended action steps to counteract BEPS highlights the sharp contrast with the simplistic and ultimately counterproductive approach taken by states that have enacted tax haven legislation.

### THE OECD/G20 APPROACH TO BEPS

In October 2015, the OECD issued the final reports of its massive two-year effort to analyze and design international tax solutions to the problems of base erosion and profit shifting.<sup>139</sup> The OECD final package was endorsed by the G20 finance ministers in a meeting on October 8, 2015 in Lima, Peru; and by the G20 country leaders in a meeting on November 15–16, 2015 in Antalya, Turkey. Conspicuously absent from the several thousand pages of OECD reports was any support for a blacklist of so-called “tax haven” nations.

The OECD BEPS project focused on 15 actions, each addressing a different part of the perceived gaps in the international tax framework. The OECD divided its analytical framework into three categories: Coherence (Actions 2–5); Substance (Actions 6–10);

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<sup>139</sup> See OECD 2015, *supra* n. 7.

and Transparency (Actions 11–14). The highlights of the OECD approach include some of the following action steps:<sup>140</sup>

- Continued reliance on a transfer pricing regime for cross border transactions coupled with stronger anti-abuse rules. In other words, strengthening the separate reporting foundation of international tax and rejecting an alternative of unitary combined reporting.
- Revision of transfer pricing rules to reflect where “value creation” takes place, particularly with regard to intangibles.
- Requiring more “substance” in the use of “patent boxes” and other tax incentive mechanisms.
- Limiting interest deductions for certain arrangements.
- Limiting mismatches of entity characterization and income/expense determinations.
- Making changes to permanent establishment jurisdictional rules.
- Requiring more transparency with country by country reporting requirements and other new disclosure rules.

The OECD BEPS actions address profit shifting in so-called tax haven countries not by ring-fencing these countries and automatically including all income earned by an affiliate in a tax haven country in another nation’s tax base. Rather, the OECD solutions target outdated tax rules applied to particular transactions and structures that do not adequately reflect where value is created.

As noted previously, the OECD used the “tax haven” list approach to pressure non-compliant nations to conform to international standards of information exchange and transparency. Once that objective was largely achieved, the OECD discontinued use of its “tax haven” list. Thus, in considering different solutions to the BEPS problem, the OECD was certainly familiar with the blacklist approach, and yet chose not to adopt it. By so doing, it avoided the pitfalls facing the states, including conflicts over the criteria used to blacklist countries and difficulties in monitoring such lists on a going forward basis.

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<sup>140</sup> OECD Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project, OECD 2015, available at <http://www.oecd.org/ctp/beps-explanatory-statement-2015.pdf>. The 15 OECD BEPS action plan groups included the following topics:

1. Address the Tax Challenges of the Digital Economy
2. Neutralise the Effects of Hybrid Mismatch Arrangements
3. Strengthen Controlled Foreign Company (CFC) Rules
4. Limit Base Erosion via Interest Deductions and Other Financial Payments
5. Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance
6. Prevent Treaty Abuse
7. Prevent the Artificial Avoidance of PE Status
8. Transfer Pricing for Intangibles
9. Transfer Pricing for Risks and Capital
10. Transfer Pricing for Other High-Risk Transactions
11. Measuring and Monitoring BEPS
12. Require Taxpayers to Disclose their Aggressive Tax Planning Arrangements
13. Re-examine Transfer Pricing Documentation
14. Make Dispute Resolution Mechanisms More Effective
15. Develop a Multilateral Instrument

Id.

In a real sense, the 2,000 page BEPS report indicates what it may take to deal with the complexities of the global taxation of corporate income. In the OECD view, BEPS is attributable to multinational entity-specific facts and circumstances, interacting with tax system differences, not the statutory or administrative features of a single country's tax system. Thus, the OECD endorsed specific action steps aimed at fixing underlying problems rather than scapegoating listed nations.<sup>141</sup>

## THE TREND TOWARD TERRITORIAL TAX SYSTEMS

The OECD's rejection of the tax haven approach is part of a longer term trend away from "worldwide" taxation and toward a "territorial" system for taxing the income of foreign subsidiaries. Currently, 28 of the 34 OECD member countries have adopted some type of a territorial system of taxation, including every G-7 nation except for the United States (e.g., Canada, France, Germany, Great Britain, Italy, and Japan).<sup>142</sup> The key feature of a territorial tax system is that it exempts from taxation most of the earnings of foreign subsidiaries. By contrast, a worldwide system taxes all of the income of a domestic corporation and its foreign affiliates (the latter typically on a deferred basis) less a credit for taxes paid to other jurisdictions. Of the 28 OECD nations with a territorial tax system, 20 countries exempt 100 percent of foreign subsidiary dividends, one country (Norway) exempts 97 percent of foreign subsidiary dividends, and seven countries exempt 95 percent of foreign subsidiary dividends.<sup>143</sup>

Indeed, the territorial tax system has rapidly gained popularity over the last 25 years. In 1989, only 10 OECD member countries had territorial tax systems and just two of the G-7 countries had this type of a tax system. In the intervening years, 18 additional OECD member countries shifted to a territorial tax system.<sup>144</sup> Just since 2000, 11 nations have switched from a worldwide taxation system to a territorial taxation system, among them Japan, the United Kingdom, Turkey and Poland. The only remaining OECD countries (beyond the U.S.) with worldwide systems of taxation are Chile, Greece, Ireland, Israel, Korea, and Mexico.<sup>145</sup>

In this regard, the trend toward a territorial tax system is analogous to the long-standing consensus among the states to limit the corporate tax base to the "water's edge"—that is, to entities doing business within the United States. In both systems, the income of foreign subsidiaries is not generally taxed unless it is "domestic" source income. The OECD BEPS project is proposing major reforms to entity characterization, income sourcing, and other cross-border rules to ensure that each nation is able to effectively capture the income earned within its borders. But in doing

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In the OECD view, BEPS is attributable to multinational entity-specific facts and circumstances, interacting with tax system differences, not the statutory or administrative features of a single country's tax system.

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<sup>141</sup> According to the overview provided by the OECD in its recently released 2015 summary of the OECD/ G20 Base Erosion and Profit Shifting Project, Addressing Base Erosion and Profit Shifting (OECD, 2013), "no single tax rule on its own enables BEPS; it is rather the interplay among different issues that makes it possible. Domestic laws and rules that are not coordinated across borders, international tax standards that have not always kept pace with the changing global business environment, and a pervasive lack of relevant information at the level of tax administrations and policy makers combine to provide opportunities for taxpayers to undertake BEPS strategies." OECD Explanatory Statement, *supra* note 140, at 5.

<sup>142</sup> Senate Finance Committee, International Tax Reform Working Group: Final Report, July 7, 2015, at 5 & 72, available at [http://www.portman.senate.gov/public/index.cfm/files/serve?File\\_id=923a866b-9c71-429a-a655-5dd0adef2caa](http://www.portman.senate.gov/public/index.cfm/files/serve?File_id=923a866b-9c71-429a-a655-5dd0adef2caa).

<sup>143</sup> *Id.* at 40–41.

<sup>144</sup> *Id.* at 3.

<sup>145</sup> Philip Dittmer, A Global Perspective on Territorial Taxation, Tax Found., August 10, 2012, at 1; Alliance for Competitive Taxation, Comments Submitted to the Senate Committee on Finance International Working Group, 2015 at 7.

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## The rise of territorial tax systems

and retreat from worldwide taxation reflects an awareness of the underlying complexities of taxing income in an increasingly global and intangible-based economy.

so, it is steering clear from any notion that the best way to tax corporate income is on a worldwide or quasi-worldwide basis—where the income of foreign subsidiaries is included in the domestic tax base simply because the foreign entities are affiliated with domestic entities in the taxing country.

To be sure, the transition to a purely territorial system is not entirely uniform. Some of the OECD countries exclude from the dividend-received deduction income earned in countries without treaties in place, that lack adequate information exchange rules, or in more limited cases that have significantly lower tax rates. Nonetheless, even in these countries, there is no attempt to tax foreign source income on a current basis (as is the case with state tax haven legislation), but rather only on a deferred basis when the income is repatriated to the home country.<sup>146</sup> Nor is there an attempt to tax the foreign source income of foreign headquartered companies, as is the case with tax haven legislation.

## THE CHALLENGES OF TAXING CORPORATE INCOME IN AN INCREASINGLY GLOBAL AND INTANGIBLE-BASED ECONOMY

The rise of territorial tax systems and retreat from worldwide taxation reflects an awareness of the underlying complexities of taxing income in an increasingly global and intangible-based economy. Indeed, even if the OECD BEPS actions succeed in reducing profit shifting opportunities, the taxation of multinational corporate income on a global basis will continue to pose significant challenges for national governments.<sup>147</sup> For the states, the important takeaway is that any new tax measures relating to foreign source income should be limited in scope and consistent with international norms.

The world is a much different place than it was in the decades following World War II. The exponential expansion of world trade and the increasing mobility of labor, capital and intangibles present new and unique challenges for allocating corporate income on a global basis.

For instance, worldwide exports as a percentage of global GDP have tripled from about 10 percent in 1960 to 30 percent in 2013 (see Figure 5).<sup>148</sup> Similarly, the value of worldwide imports (valued in constant 2005 dollars) increased from about \$877 billion in 1960 to nearly \$17.7 trillion in 2013 (see Figure 6).<sup>149</sup>

Moreover, the global economy has shifted decisively from one based on tangible property and goods to one characterized by intangible property and services. According to an annual survey of intangible asset market value, the intangible assets component of the

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<sup>146</sup> The one exception to this is nations that have rules similar to the US subpart F rules and tax the “passive” income of certain controlled foreign corporations on a “current” basis. Furthermore, the European Commission is currently considering other options that would impact current income. See *supra* n. 51.

<sup>147</sup> As stated by the OECD in a summary to its BEPS report, “Although some schemes used are illegal, most are not. Largely they just take advantage of current rules that are still grounded in a bricks and mortar economic environment rather than today’s environment of global players which is characterized by the increasing importance of intangibles and risk management.” OECD: Centre for Tax Policy and Administration, BEPS—Frequently Asked Questions, Question 118, <http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm>.

<sup>148</sup> The World Bank, World Development Indicators, Exports of goods and services (% of GDP) (2015), available at <http://data.worldbank.org/indicator/NE.EXP.GNFS.ZS>.

<sup>149</sup> The World Bank, World Development Indicators, Imports of goods and services (constant 2005 US\$) (2015), available at <http://data.worldbank.org/indicator/NE.IMP.GNFS.KD>.

S&P 500 market value increased from 17 percent in 1975 to 84 percent in 2015.<sup>150</sup> In addition, spending on services (as a percentage of personal consumption) has spiked in the U.S. from 53 percent in 1970 to 67 percent in 2014.<sup>151</sup> Finally, the very nature of consumer spending is undergoing a radical change as exemplified by estimates that purchases by mobile devices will constitute one-half of all e-commerce sales by 2018.<sup>152</sup>

One important outcome of the “new” global economy is that businesses can operate effectively in foreign countries with little or no physical presence—something that was not possible even 20 years ago. Advances in digital and communications technology allow businesses to operate remotely in a wide range of industries including retail, business services, health care, education and entertainment. This creates a disconnect between earned profits and traditional factors such as labor and property, and adds to the pressure to modernize international tax rules.

The activities of U.S. multinationals are a byproduct of this globalization trend. According to the Report of the Senate Finance Committee’s International Tax Overhaul Working Group, in 1982, U.S. multinationals earned only about 23 percent of their income from outside the United States.<sup>153</sup> In 2012, U.S. multinationals earned 54 percent of their income from outside the United States.<sup>154</sup> In terms of long-term strategy, this shift makes sense since 95 percent of the world’s consumers are located outside the United States.<sup>155</sup>

Globalization has also intensified tax competition among nations, as countries compete to attract investment, jobs, and high value-added intellectual property in an increasingly mobile and transitory world economy. Corporate income tax rates among OECD countries range from 5.7 percent to 36 percent.<sup>156</sup> Many European countries, including the United Kingdom, France, Netherlands, Spain and Italy, have sharply reduced income tax rates for qualifying intangible property.<sup>157</sup> Twelve EU countries have or are in the process of obtaining “patent box” regimes that provide low tax rates, averaging less than 10 percent, for patents and other kinds of intellectual property income.<sup>158</sup> Even with BEPS reforms, international tax competition will

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...the intangible assets component of the S&P 500 market value increased from 17 percent in 1975 to 84 percent in 2015.

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<sup>150</sup> Kristi Stathis, Ocean Tomo Releases 2015 Annual Study of Intangible Asset Market Value, March 5, 2015, available at <http://www.oceantomo.com/blog/2015/03-05-ocean-tomo-2015-intangible-asset-market-value/>.

<sup>151</sup> U.S. Bureau of Economic Analysis, Advanced Download Section: Section 2, Personal Consumption Expenditures by Major Type of Product, available at <http://www.bea.gov/national/nipaweb/DownSS2.asp>.

<sup>152</sup> Bill Siwicki, Mobile Commerce Will be Nearly Half of E-Commerce by 2018, *InternetRetailer.com*, March 10, 2014; Alexis C. Madrigal, Goldman: There Will Be as Much Mobile Commerce in 2018 as E-Commerce in 2013, *TheAtlantic.com*, Mar. 6, 2014, available at <http://www.theatlantic.com/technology/archive/2014/03/goldman-there-will-be-as-much-mobile-commerce-in-2018-as-br-e-commerce-in-2013/284270/>.

<sup>153</sup> Senate Finance Committee, *supra* note 142, at 5.

<sup>154</sup> *Id.*

<sup>155</sup> *Id.* at 5–6. Viewing longer-term trends, there has been not only an acceleration of trade among nations, but also a change of relative economic fortunes as between developed and developing nations. According to PwC estimates, in 2009, the G-7 nations (US, Japan, Germany, UK, France, Italy, Canada) had \$29 trillion in combined GDP compared to \$20.9 trillion in the E-7 nations (China, India, Brazil, Russia, Indonesia, Mexico, Turkey).<sup>156</sup> By 2050, the G-7 nations will have an estimated \$69.3 trillion in GDP compared to an estimated \$138.2 trillion GDP in the E-7 nations. PricewaterhouseCoopers, *Five Megatrends and Possible Implications*, April 2014, at 8, available at <https://www.pwc.com/us/en/corporate-governance/publications/assets/pwc-corporate-governance-directors-megatrends.pdf>.

<sup>156</sup> Jack Mintz & Duanjie Chen, The U.S. Corporate Effective Tax Rate: Myth and the Fact, *The Tax Foundation*, Feb. 6, 2014, available at <http://taxfoundation.org/article/us-corporate-effective-tax-rate-myth-and-fact>.

<sup>157</sup> PricewaterhouseCoopers, *European Patent Box Regimes*, Prepared for Japan External Trade Organisation, April 2013, at 13, available at [https://www.jetro.go.jp/ext\\_images/world/europe/ip/pdf/european\\_patent\\_box\\_regimes\\_en.pdf](https://www.jetro.go.jp/ext_images/world/europe/ip/pdf/european_patent_box_regimes_en.pdf).

<sup>158</sup> Alliance for Competitive Taxation, *supra* note 145, at 9.

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While much of the BEPS project is focused on aligning corporate profits with the place “where value is created”, there is no single, widely accepted answer to this question.

not somehow magically disappear. Indeed, the OECD is not seeking to eliminate differential tax rates and incentives among nations, but rather to regulate their rationality (*e.g.*, require more substance in patent boxes) and transparency (*e.g.*, require more disclosure by governments of tax incentives provided to companies).

While the OECD BEPS project represents perhaps the most comprehensive set of international tax reforms ever proposed, nations will continue to search for the most effective ways to tax multinational corporations. There is still no “one size fits all” solution for sourcing global income. Countries are likely to prioritize different factors in cross-border taxation, depending on their own geopolitical and economic interests.

While much of the BEPS project is focused on aligning corporate profits with the place “where value is created”, there is no single, widely accepted answer to this question. For instance, with regard to an intangible such as a patent, is the value created in the country where the research and development primarily took place, where the intangible is managed, where manufactured products relating to the patent are produced, where corporate financing is managed, where back office support services are located, where the customers are located, or some combination thereof? According to a 2015 Deloitte survey, three-quarters of multinational businesses agree or strongly agree that double taxation will result as countries assign differential importance to all of these factors, depending on their own economic interests.<sup>159</sup>

States are certainly familiar with the inherent tension and controversy in determining where value is created (and should be taxed), with significant shifts occurring over the last three decades between three factor apportionment formulas and single sales factor apportionment formulas, and between cost-of-performance sourcing of services and intangibles and market state sourcing.

Globalization presents unique challenges to sovereign governments to find a rational way to allocate the income of multinational companies among several hundred nations. In this environment, it is more important than ever for governments, particularly subnational governments such as the U.S. states, to steer clear of overly simplistic or overly broad approaches to foreign source income that cause more harm than good.

## THE LESSONS FROM FEDERAL TAX POLICY AS AN INTERNATIONAL “OUTLIER”

One of the “poster” countries for how not to tax global business is the United States. The United States operates outside international norms in tax policy, with federal tax rates and rules on taxing foreign source income which place the United States at a competitive disadvantage in world markets. The United States is currently the only developed country with both a worldwide system of taxation and a corporate income tax rate above 30 percent.<sup>160</sup> As discussed above, over four-fifths of all OECD countries now have a territorial tax system. In addition, over the last

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<sup>159</sup> Deloitte, OECD’s Base Erosion and Profit Shifting (BEPS) Initiative: Summary Results of Second Annual Multinational Survey, May 2015, at 2, available at <http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-beps-summary-survey-results-may-2015.pdf>.

<sup>160</sup> Ernst & Young, Charting a Course on Tax Reform—Considerations of Moving the US to a Territorial Tax System, January 2012, available at [http://www.ey.com/Publication/vwLUAssets/Charting\\_a\\_course\\_on\\_tax\\_reform\\_-\\_considerations\\_of\\_moving\\_the\\_US\\_to\\_a\\_territorial\\_tax\\_system/\\$FILE/EY\\_tax\\_news\\_2012011008.pdf](http://www.ey.com/Publication/vwLUAssets/Charting_a_course_on_tax_reform_-_considerations_of_moving_the_US_to_a_territorial_tax_system/$FILE/EY_tax_news_2012011008.pdf).

18 years, 30 industrialized nations have reduced their corporate income tax rate.<sup>161</sup> In 1999, the average corporate tax rate in the OECD countries was 35 percent.<sup>162</sup> Today it is 24 percent.<sup>163</sup> However, the U.S. rate has remained virtually unchanged at 35 percent—and now ranks as the highest marginal corporate income tax rate among the OECD countries.<sup>164</sup>

The costs of its “outlier” status in the international tax arena are mounting. Under the current U.S. “worldwide” taxation rules, tax on “active” foreign source income is deferred until the profits are repatriated in the form of foreign dividends. However, with the high federal income tax rate there is a strong disincentive to bring the profits home, and the deferral takes on a semi-permanent status. According to a study in 2015, approximately \$2.1 trillion dollars of deferred income has accumulated offshore untaxed by the U.S., increasing at an average of eight percent yearly.<sup>165</sup>

The high U.S. tax rate relative to other industrialized nations is also contributing to foreign acquisitions of U.S. companies. A 2015 Ernst & Young study for the Business Roundtable found the outdated federal tax code led to a \$179 billion net loss of American companies and business assets to foreign buyers from 2003–2013.<sup>166</sup> If the U.S. corporate tax rate had been reduced to 25 percent, U.S. companies would have acquired \$590 billion in cross border assets over the 10-year period instead of losing \$179 billion (a net shift of \$769 billion in assets from foreign countries to the United States).<sup>167</sup> A corollary of this trend is the increase in corporate inversions, with U.S. headquartered companies switching to foreign ownership to reduce U.S. federal tax bills.

A number of studies have criticized the U.S. system of taxing global revenues and opined that an approach that is so out of sync with the territorial tax rules in most other OECD nations is likely unsustainable.<sup>168</sup> There are striking parallels between

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**The United States** operates outside international norms in tax policy, with federal tax rates and rules on taxing foreign source income which place the United States at a competitive disadvantage in world markets.

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<sup>161</sup> Kyle Pomerleau & Andrew Lundeen, The U.S. Has the Highest Corporate Income Tax Rate in the OECD, The Tax Foundation, Jan. 27, 2014, available at <http://taxfoundation.org/blog/us-has-highest-corporate-income-tax-rate-oecd>.

<sup>162</sup> Tax Foundation, OECD Corporate Income Tax Rates, 1981–2013, December 18, 2013, available at <http://taxfoundation.org/article/oecd-corporate-income-tax-rates-1981-2013>.

<sup>163</sup> Derek Tsang, Does the U.S. have the highest corporate tax rate in the free world?, Politifact, Sep. 9, 2014, available at <http://www.politifact.com/punditfact/statements/2014/sep/09/eric-bolling/does-us-have-highest-corporate-tax-rate-free-world/>.

<sup>164</sup> Dittmer, *supra* note 145, at 8.

<sup>165</sup> Senate Finance Committee, *supra* note 142, at 78.

<sup>166</sup> Ernst & Young, *supra* note 127, at 3.

<sup>167</sup> Ernst & Young, *supra* note 127, at i. In the first 8 months of 2015, the value of foreign takeovers of U.S. companies rose to \$379 billion compared to \$71 billion for the same period in 2013. Liz Hoffman & John D. McKinnon, Curbs Don't Stop Tax-Driven Mergers, THE WALL STREET JOURNAL, Sept. 22, 2015, at C2.

<sup>168</sup> See e.g., Alliance for Competitive Taxation, Comments Submitted to the Senate Committee on Finance International Working Group, 2015, at 7 (discussing OECD and G-7 countries utilizing a territorial tax system); Lars P. Feld, Martin Ruf, Uwe Scheuering, Ulrich Schreiber, & Johannes Voget, Effects of Territorial and Worldwide Corporation Tax Systems on Outbound M&A's, Center for European Economic Research, Discussion Paper No. 13-088 (2013) (emphasizing the benefits the U.S. would receive by employing a territorial system of international taxation); Liz Hoffman & John D. McKinnon, Foreign Takeovers See U.S. Losing Tax Revenue: Wave of tie-ups is steering more money out of Uncle Sam's coffers, Wall St. J., March 5, 2015 (explaining the use of corporate inversions to change the citizenship of U.S. corporations to reduce their taxes).



the U.S. and other countries like UK and Japan that were forced to abandon uncompetitive and out of sync worldwide tax regimes in recent years.<sup>169</sup>

The latest indication of bipartisan support in the U.S. Congress for international tax reform is the 2015 report by the Senate Finance Committee International Tax Overhaul Working Group headed by Senator Rob Portman (R-Ohio) and Senator Charles Schumer (D-NY). This report highlights the global competitiveness risks to the U.S. of its current tax policies, and calls for radical changes in U.S. international tax rules including support for 1) a quasi-territorial tax regime and 2) “patent box” legislation.<sup>170</sup> Undoubtedly, federal tax reform will face many legislative obstacles, but the pressure to conform the U.S. tax system more closely with the international tax system continues to build.

## CONCLUSION

U.S. tax policy is not only a drag on U.S. international competitiveness, but it also constrains the options for state tax action. Certainly, state action is possible without federal tax reform. But since federal tax rates and tax base are a much larger determinant of international corporate behavior than state tax rates and tax base, it will be difficult to effectively address some of the underlying problems without federal tax reform.

Of equal import, the negative impact on tax competitiveness of out-of-sync federal tax rules should provide a cautionary tale—especially to subnational governments (such as the U.S. states)—about the costs of straying too far from international norms on taxing foreign source income. State “tax haven” legislation runs counter to international tax reform efforts. State tax haven blacklists are arbitrary, unmanageable, and possibly unconstitutional. Further, these measures antagonize U.S. trading partners and inhibit in-state investment. The ultimate justification for these proposals—purported state revenue lost to income shifting—is based on faulty assumptions and is belied by the relatively constant (and even growing) business contribution to state and local finances.

Over the last three decades, states have uniformly rejected worldwide combined reporting in favor of a water’s-edge filing method that generally includes domestic corporations and excludes foreign corporations. To diverge from this consensus and enact state tax haven legislation reflects a fundamental misunderstanding of both the need for and efficacy of these policies.

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<sup>169</sup> In a paper prepared for the Tax Foundation entitled “A Global Perspective on Territorial Taxation”, Philip Dittmer concludes: “Like Japan before 2009, American companies’ foreign profits are stockpiling abroad, locked out by a secondary tax penalty. Like the UK before 2009, many U.S. companies have explored or gone forward with moving legal residence into business-friendly tax systems. Like both countries before reform, the U.S. system is complex, **out of sync** with its major trading partners, and imposes heavy, uncompetitive burdens...It is not by accident that 27 of 34 OECD members have territorial systems [now 28], and that every independent government tax advisory group has encouraged Congress to discard the current worldwide system in favor of a sleeker territorial model...Territorial taxation has been called “a pragmatic response to the practicalities in a world where competition is fast moving and truly global”. Philip Dittmer, *supra* note 145, at 25–28, quoting Martin A. Sullivan, *The Economic Case for Unlocking Foreign Profits*, 136 *Tax Notes* 11 (2012).

<sup>170</sup> Senate Finance Committee, *supra* note 142, at 40–42.

# APPENDIX 1: SUMMARY OF STATE TAX HAVEN LEGISLATION

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## ALASKA

**Criteria:** Regulation (15 AAC 20.900) defines “tax haven” corporation by reference to statute to mean “a corporation that is incorporated in or does business in a country that does not impose an income tax, or that imposes an income tax at a rate lower than 90 percent of the United States income tax rate on the income tax base of the corporation in the United States, if

A. 50 percent or more of the sales, purchases, or payments of income or expenses, exclusive of payments for intangible property, of the corporation are made directly or indirectly to one or more members of a group of corporations filing under the water’s-edge combined reporting method;

B. the corporation does not conduct significant economic activity.”

**Inclusion Rule:** A corporation that is a member of an affiliated group shall file a return using the water’s-edge combined reporting method. A return under this section must include [tax haven] corporations if the corporations are part of a unitary business with the filing corporation.

**Exceptions:** None.

**Adoption/Amendments:** Adopted by 1991 Alaska Laws. C. 11, Sec. 3 (Alaska Stat. Sec. 43.20.073, renumbers as Alaska Stat. Sec. 43.20.145).

## CONNECTICUT

**Criteria:** A jurisdiction that:

- A. has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;
- B. has a tax regime which lacks transparency;
- C. facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;
- D. explicitly or implicitly excludes the jurisdiction's resident taxpayers from taking advantage of the tax regime benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction's domestic market; or
- E. has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial or services sector relative to its overall economy.

Further, "tax haven" does not include a jurisdiction that has entered into a comprehensive income tax treaty with the United States, which the Secretary of the Treasury has determined is satisfactory for purposes of Section 1(h)(11)(C)(i)(II) of the Internal Revenue Code.

**Inclusion Rule:** Includes within the water's-edge return any member that is incorporated in a jurisdiction that is determined by the commissioner to be a tax haven as defined.

**Exceptions:** If "proven to the satisfaction of the commissioner that such member is incorporated in a tax haven for a legitimate business purpose[.]" Also, a "whitelist" of protected jurisdictions applies: "Tax haven" does not include a jurisdiction that has entered into a comprehensive income tax treaty with the United States, which the Secretary of the Treasury has determined is satisfactory for purposes of Section 1(h)(11)(C)(i)(II) of the Internal Revenue Code.

**Adoption/Amendments:** Adopted by Public Act 15-244 (H.B. 7061), as amended by Public Act 15-5 (S.B. 1502) and Public Act 15-1 (Dec. 2015 SS) (S.B. 1601) (repealed list requirement).

## DISTRICT OF COLUMBIA

**Criteria:** Any jurisdiction that:

- i. For a particular tax year in question has no, or nominal, effective tax on the relevant income and has laws or practices that prevent effective exchange of information for tax purposes with other governments regarding taxpayers benefitting from the tax regime;
- ii. Lacks transparency, which, for the purposes of this definition, means that the details of legislative, legal, or administrative provisions are not open to public scrutiny and apparent or are not consistently applied among similarly situated taxpayers;
- iii. Facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;
- iv. Explicitly or implicitly excludes the jurisdiction's resident taxpayers from taking advantage of the tax regime's benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction's domestic market; or
- v. Has created a tax regime that is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial or other services sector relative to its overall economy.

**List:** Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Cyprus, Dominica, Gibraltar, Grenada, Guernsey-Sark-Alderney, Isle of Man, Jersey, Liberia, Liechtenstein, Luxembourg, Malta, The Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, The islands formerly constituting the Netherlands Antilles, Niue, Samoa, San Marino, Seychelles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Turks and Caicos Islands, U.S. Virgin Islands, and Vanuatu. [Repealed by Fiscal Year 2016 Second Budget Support Clarification Emergency Amendment Act of 2015].

**Inclusion Rule:** Income and apportionment factors of unitary affiliated corporations included in water's edge return if affiliate is doing business in a tax haven jurisdiction.

**Exceptions:** If the member's business activity within a tax haven is entirely outside the scope of the laws, provisions, and practices that cause the jurisdiction to meet the criteria of a tax haven, the activity of the member shall be treated as not having been conducted in a tax haven.

**Adoption/Amendments:** Adopted by 2011 DC Laws 19–21 (DC Code Sec. 47-1801.04 & 1810.07), amended by 2015 Laws 21–36 to add a tax haven list (deleted by Fiscal Year 2016 Second Budget Support Clarification Emergency Amendment Act of 2015).

## MONTANA

**List:** Andorra, Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Cyprus, Dominica, Gibraltar, Grenada, Guernsey-Sark-Alderney, Isle of Man, Jersey, Liberia, Liechtenstein, Luxembourg, Malta, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, Niue, Panama, Samoa, San Marino, Seychelles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Turks and Caicos Islands, U.S. Virgin Islands, and Vanuatu.

**Inclusion Rule:** Income and apportionment factors of unitary affiliated corporations included in water's edge return if affiliate is incorporated in a listed tax haven jurisdiction.

**Exceptions:** None.

**Adoption/Amendments:** Adopted by 2003 Montana Laws Ch. 521 (H.B. 721), amending Mont. Code Ann. Sec. 15-31-322. Further amended in 2009 to add Cyprus, Malta, Mauritius, and San Marino to the list of tax havens, and remove Maldives and Tonga (2011 S.B. 43).

## OREGON

**List:** Andorra, Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Bahrain, Barbados, Belize, Bermuda, Bonaire, the British Virgin Islands, the Cayman Islands, the Cook Islands, Curacao, Cyprus, Dominica, Gibraltar, Grenada, Guatemala, Guernsey-Sark-Alderney, the Isle of Man, Jersey, Liberia, Liechtenstein, Luxembourg, Malta, the Marshall Islands, Mauritius, Montserrat, Nauru, Niue, Saba, Samoa, San Marino, Seychelles, Sint Eustatius, Sint Maarten, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Trinidad and Tobago, the Turks and Caicos Islands, the U.S. Virgin Islands and Vanuatu.

**Inclusion Rule:** The taxable income or loss of any corporation that is a member of a unitary group or that is a corporation that files a separate return and that is incorporated in [a tax haven] shall be added to the federal consolidated taxable income of the unitary group filing a consolidated Oregon return or to the federal taxable income of the corporation filing a separate return.

**Exceptions:** Taxpayer is not precluded from asserting alternative apportionment should apply. Also, the income of the foreign corporation is not to be double taxed by the state, and the taxpayer may subtract any portion of the tax haven income previously included in Oregon taxable income (Regulation 150-317.715(5)).

**Adoption/Amendments:** Adopted by 2013 Oregon Laws Ch. 707 (H.B. 2460), amending O.R.S. Sec. 317.715). 2015 S.B. 61 replaced Netherlands Antilles with Bonaire, Curacao, Saba, Sint Eustatius and Sint Maarten; deleted Monaco; added Guatemala and Trinidad and Tobago (among other changes, including repeal of apportionment factor representation).

## RHODE ISLAND

**Criteria:** A jurisdiction that, during the tax year in question has no or nominal effective tax on the relevant income and;

- i. has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;
- ii. has a tax regime which lacks transparency. A tax regime lacks transparency if the details of legislative, legal, or administrative provisions are not open and apparent, or are not consistently applied among similarly situated taxpayers, or if the information needed by tax authorities to determine a taxpayer's correct tax liability, such as accounting records and underlying documentation is not adequately available;
- iii. facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;
- iv. explicitly or implicitly excluded the jurisdiction's resident taxpayers from taking advantage of the tax regime benefits or prohibits enterprisers that benefit from the regime from operating in the jurisdiction's domestic market; or
- v. has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.

**Inclusion Rule:** If a non US corporation is includible as a member in the combined group, to the extent that such non US corporation's income is subject to the provisions of a federal income tax treaty, such income is not includible in the combined group net income.

*However*, "federal income tax treaty" does not include an income tax treaty between the United States and a foreign jurisdiction which is defined as a tax haven.

**Exceptions:** If the tax administrator determines that a combined group member non US corporation is organized in a tax haven that has a federal income treaty with the United States, its income subject to a federal income tax treaty, and any expenses or apportionment factors attributable to such income, shall not be included in the combined group net income or combined report if:

- i. the transactions conducted between such non US corporation and other members of the combined group are done on an arm's length basis and not with the principal purpose to avoid the payment of taxes due under this chapter; or
- ii. the member establishes that the inclusion of such net income in combined group net income is unreasonable.

**Adoption/Amendments:** Adopted by P.L. 2014, ch. 145 (R.I. Gen. Laws Secs. 44-11-1 & 44-11-4.1).

## WEST VIRGINIA

**Criteria:** A jurisdiction that has no, or nominal, effective tax on the relevant income and:

- i. That has laws or practices that prevent effective exchange of information for tax purposes with other governments regarding taxpayers subject to, or benefitting from, the tax regime;
- ii. that lacks transparency. For purposes of this definition, a tax regime lacks transparency if the details of legislative, legal or administrative provisions are not open to public scrutiny and apparent or are not consistently applied among similarly situated taxpayers;
- iii. facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;
- iv. explicitly or implicitly excludes the jurisdiction's resident taxpayers from taking advantage of the tax regime's benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction's domestic market; or
- v. has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial or other services sector relative to its overall economy.

**List:** A jurisdiction that, for a particular tax year in question is identified by the Organization for Economic Cooperation and Development as a tax haven or as having a harmful preferential tax regime; provided that all amendments made to the most recent list or compilation of jurisdictions identified as a tax haven or as having a harmful preferential tax regime that were issued, published or adopted by the Organization for Economic Cooperation and Development after March 8, 2008, but prior to January 1, 2011, shall be given effect in determining whether a jurisdiction is a tax haven.

**Inclusion Rule:** Water's-edge return includes the income and factors of any member that is doing business in a tax haven.

**Exceptions:** If the member's business activity within a tax haven is entirely outside the scope of the laws, provisions and practices that cause the jurisdiction to meet the criteria set forth in the definition of a tax haven, the activity of the member shall be treated as not having been conducted in a tax haven.

**Adoption / Amendments:** Adopted by Acts 2008, c. 215 (S.B. 680), (W.Va. Code Secs. 11-24-3a & -3b; 11-24-13f). Amended by Acts 2011, c. 173, to retroactively include all OECD list changes made after March 8, 2008, but prior to January 1, 2011.

## MULTISTATE TAX COMMISSION

**Criteria:** “Tax haven” means a jurisdiction that, during the tax year in question has no or nominal effective tax on the relevant income and:

- i. has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;
- ii. has tax regime which lacks transparency. A tax regime lacks transparency if the details of legislative, legal or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers, or if the information needed by tax authorities to determine a taxpayer’s correct tax liability, such as accounting records and underlying documentation, is not adequately available;
- iii. facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;
- iv. explicitly or implicitly excludes the jurisdiction’s resident taxpayers from taking advantage of the tax regime’s benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction’s domestic market; or
- v. has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.

**Inclusion Rule:** Includes within the water’s-edge return the entire income and apportionment factors of any member that is doing business in a tax haven, where “doing business in a tax haven”.

**Exceptions:** If the member’s business activity within a tax haven is entirely outside the scope of the laws, provisions and practices that cause the jurisdiction to meet the criteria of a tax haven, the activity of the member shall be treated as not having been conducted in a tax haven.

**Adoption/Amendments:** Adopted by Multistate Tax Commission on August 17, 2006, amended on July 29, 2011 to remove reference to OECD list and references to OECD with respect to the criteria.



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[Redacted]

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**ORGANIZATION *for* INTERNATIONAL INVESTMENT**  
Global Investment Grows America's Economy

September 12, 2016

Jason Larimer  
Oregon Department of Revenue  
955 Center St NE  
Salem, OR 97301

Re: OAR 150-317.717

Dear Mr. Larimer,

The Organization for International Investment (OFII) appreciates the opportunity to submit feedback to the Oregon Department of Revenue (Department) about whether Ireland, Jordan, Lebanon, Malaysia, Macau, Portugal, and the United Arab Emirates should be added to the jurisdictions listed at ORS 317.716(1)(b). Rather than debate which jurisdictions should be added or removed from the list every two years, OFII believes the Department should work to strike ORS 317.716 altogether. There are alternative approaches to address tax haven concerns that do not target legitimate business activities and create disputes with U.S. trading partners and allies.

OFII is a U.S. business association representing the U.S. subsidiaries of global companies headquartered outside the United States, including many of Oregon's largest employers (membership list attached). OFII advocates for policies that increase U.S. competitiveness in attracting foreign direct investment (FDI) and provide non-discriminatory treatment for global businesses investing in the United States.

We believe the listing of jurisdictions under ORS 317.716 directly undermines Oregon's efforts to recruit and attract investment and new jobs from any business that operates in a listed jurisdiction. Such investment is important to the state. For example, the U.S. subsidiaries of global companies support 201,100 jobs in the state.<sup>1</sup> Importantly, compensation for employees of U.S. subsidiaries is 33 percent higher than the private sector average.<sup>2</sup>

Beyond these economic development concerns, we believe this policy is flawed for many reasons, as outlined below. Others agree because the tax haven blacklist approach has been rejected by every other state which considered it, except Montana, over the last 13 years.

The blacklist approach also carries many inherent difficulties in Department administration and company compliance. As Department representatives have stated publicly, the revenue figures are falling short from original fiscal estimates and significant Department resources and time have been utilized for such little return.

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<sup>1</sup> Statistic from the "[Jobs We Need](#)" report, prepared by PwC for the Organization for International Investment, 2016

<sup>2</sup> Statistic from the latest data from the U.S. Department of Commerce's Bureau of Economic Analysis (BEA), December 2015 regarding the U.S. subsidiaries of foreign headquartered companies.

ORS 317.716 creates significant consequences for the state, including:

- **Hurts state’s efforts to attract and retain FDI:** This policy undermines economic development efforts to attract investment directly from any domestic or foreign headquartered company with affiliates in the listed nations. The uncertainty of which jurisdictions will be added to the list and the tax treatment other global companies receive in Oregon could hurt the state’s outreach efforts across the globe.
- **Harms Oregon’s competitiveness:** Most states do not pursue a tax haven blacklist approach because the labeling of countries runs counter to the very type of policy that drives economic growth to their markets. For instance, California’s legislature conducted an extensive examination of a “tax haven” blacklist approach and rejected it.<sup>3</sup> In addition, Connecticut, the District of Columbia, and Rhode Island – the last three states that looked to adopt the blacklist – all rejected it in the end.
- **Undermines the spirit of bilateral tax treaties:** The policy lacks a clear exemption for income that is subject to an income tax treaty between the United States and other nations. These agreements provide a reliable tax environment for companies operating across borders by preventing double taxation of cross-border transactions between affiliated companies (i.e. royalties and interest) and creating information sharing agreements between governments. Tax treaties ensure that proper taxes are paid and also incentivize cross-border investment and trade. On the other hand, ORS 317.716 imposes tax on the very income streams that tax treaties protect from double taxation at the federal level.

This concern is particularly relevant because both Ireland and Portugal have existing tax treaties with the United States; and announced in August, Ireland and the United States began discussions to update their bilateral tax treaty. At minimum, U.S. tax treaty partners should not face the threat of being added to a blacklist because such concerns are already addressed at the highest levels of government.

- **Invites retaliatory legislation from other countries aimed at Oregon businesses** Since pursuit of this income by the state would undermine the U.S. tax treaty network, this perceived encroachment could encourage retaliation by trading partners and allies.
- **Creates Constitutional disputes:** The U.S. Supreme Court has previously struck down state laws that frustrate Congress’s ability to “speak with one voice” in its foreign dealings as regulated by the Foreign Commerce Clause. For example, the Court struck down a unique California tax practice based partially on concerns it would interfere with the ability of Congress to speak with one voice, see *Japan Lines, Ltd. V. Los Angeles County*, 441 U.S. 434 at 450 (1979). ORS 317.716 taxes corporations based solely on the fact that they are engaging in business in a certain jurisdiction. While the blacklist issue has not been adjudicated by the Courts, this policy could frustrate and interfere with the federal government’s ability to regulate and maintain its relations with foreign governments.

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<sup>3</sup> California Report:

[http://caleuropeantrade.senate.ca.gov/sites/caleuropeantrade.senate.ca.gov/files/Waters\\_Edge\\_CA\\_Jobs\\_and\\_International\\_Investment\\_Opportunities\\_5-19-2010.pdf](http://caleuropeantrade.senate.ca.gov/sites/caleuropeantrade.senate.ca.gov/files/Waters_Edge_CA_Jobs_and_International_Investment_Opportunities_5-19-2010.pdf)

For these reasons, OFII believes that the state should strike ORS 317.716 rather than debate which jurisdictions should be added to the list every two years. We stand ready to assist state efforts to develop a better policy that addresses tax haven concerns without all the consequences of the blacklist approach.

Thank you for the opportunity to comment. Please contact Evan Hoffman, OFII's Senior Manager of State Government Affairs, at [ehoffman@ofii.org](mailto:ehoffman@ofii.org) or (202) 659-1903, for additional information.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Nancy McLernon', with a long horizontal flourish extending to the right.

Nancy McLernon  
President & Chief Executive Officer  
Organization for International Investment



OFII is the only business association in Washington D.C. that exclusively represents U.S. subsidiaries of foreign companies and advocates for their non-discriminatory treatment under state and federal law.

### **Members**

ABB Inc.	Ferguson Enterprises, Inc.	Rio Tinto America
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Beam Suntory	John Hancock Life Insurance Co.	Solvay America
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bioMérieux	Lenovo	Swiss Re America Holding Corp.
BNP Paribas	L'Oréal USA, Inc.	Syngenta Corporation
Boehringer Ingelheim Corp.	Louisiana Energy Service (LES)	Takeda North America
Bombardier Inc.	Louis Dreyfus Commodities	The Tata Group
BP	Louisville Corporate Services, Inc.	Tate & Lyle
Braskem	LVMH Moët Hennessy Louis Vuitton	TE Connectivity
Bridgestone Americas Holding	LyondellBasell	Teva Pharmaceuticals USA
BT	Macquarie Aircraft Leasing Services	Thales USA, Inc.
Bunge Ltd.	Maersk Inc	Thomson Reuters
Bunzl USA, Inc.	Magna International	ThyssenKrupp North America, Inc.
Cemex USA	Mallinckrodt	Toa Reinsurance Company of America
CGI Group	Marvell Semiconductor	TOTAL Holdings USA, Inc.
Chubb	McCain Foods USA	Toyota Motor North America
CNH Industrial Compass	Medtronic, Inc.	Transamerica
Group USA Continental	Michelin North America, Inc.	Tyco
Corporation	Morton Salt, Inc.	UBS
Credit Suisse Securities (USA)	National Grid	UCB
Daiichi Sankyo, Inc.	Nestlé USA, Inc.	Umicore
Daimler	The Nielsen Company	Unilever
Dassault Falcon Jet Corp.	Nissan	Vivendi
Dassault Systemes	Nokia	Vodafone
DENSO	Nomura Holding America, Inc.	Volkswagen of America, Inc.
Deutsche Telekom	Novartis Corporation	Volvo Group North America
Diageo, Inc.	Novo Nordisk Pharmaceuticals	Westfield LLC
DPx Patheon	Oldcastle, Inc.	White Mountains, Inc.
DSM North America	ORIX USA	Willis Towers Watson
Electrolux North America	Panasonic Corp. of North America	Wipro Inc.
EMD Serono Inc.	Pearson Inc.	Wolters Kluwer U.S. Corporation
Enel Green Power North America	Pernod Ricard USA	WPP Group USA, Inc.
ENGIE	Philips Electronics North America	XL Global Services
E.ON North America	QBE the Americas	Zurich Insurance Group
Ericsson	Randstad North America	
Evonik	RELX Group	
Experian	Restaurant Brands International	

## Response to COST and OFII

The department appreciates the feedback received from COST and OFII in regard to listed jurisdictions. Both COST and OFII submitted their feedback on September 12, 2016. Their feedback is together because both organizations submitted similar feedback.

In summary, COST and OFII both raise the following issues with Oregon's listed jurisdiction laws:

- Individually identifying particular countries as listed jurisdictions is inherently arbitrary and misleading. They point out that recent global efforts to combat tax avoidance do not rely on identifying specific jurisdictions.
- Also, they believe listed jurisdiction laws are a step in the direction of worldwide unitary combination.
- OFII's letter also points out various other possible impacts of ORS 317.716. For example, ORS 317.716 could create constitutional disputes and could hurt Oregon's ability to attract foreign investment.

Ultimately, the department takes the position that the Legislature determines the state's tax policy and the department's has a voice in issues that involve tax administration. ORS 317.716 is administratively workable and does rely on objective criteria. Also, ORS 317.716 does not inevitably lead to worldwide unitary combination because ORS 317.716 only requires an add-back of net income from certain countries that meet the listed jurisdiction criteria.